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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1982

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NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

v.

KERR-McGEE CORPORATION, a Delaware corporation,
*Respondent.*

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NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation and PHILLIPS PETROLEUM COMPANY, a Delaware corporation,
*Respondents.*

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**On Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

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## PETITION FOR CERTIORARI

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WM. H. BROWN, *Counsel of Record*
500 Petroleum Building
Casper, WY 82601
(307) 265-9210
*Counsel of Record for Northern Utilities, Inc., Petitioner*

WM. BRYCE ARENDT
P.O. Box 2800
Casper, WY 82602
(307) 235-1541
*Associate Counsel for Northern Utilities, Inc., Petitioner*

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## QUESTIONS PRESENTED

1. In holding that a price escalator clause in a contract for the sale of natural gas is not unconscionable, whether the court of appeals erred in neglecting to consider the following six facts:

   (1) The language of the clause was entirely drafted by the producer and is "unique"; it was purposefully crafted to be "definitely indefinite".

   (2) The producer intended that the clause should adopt a nominally higher "price" by reference to a third party sale without proper adjustment for differences in measurement factors.

   (3) The producer intended the clause to serve as a mechanism to charge for more heat content that the gas contains.

   (4) The producer intended by use of the clause to collect from the purchaser, as reimbursement for taxes, substantial sums of money in excess of the taxes paid.

   (5) The lever employed by the producer to secure the clause misled the purchaser to believe that the clause merely provided for a small premium over the price at which the gas could be sold in interstate commerce.

   (6) The resale of 40% of the gas back to the producer is transformed into an operating loss through application of the clause.

2. Whether the court of appeals erred in holding that the price escalator clause in this case is not contrary to public policy.

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### OPINIONS BELOW

United States Court of Appeals for the Tenth Circuit: *Kerr-McGee Corporation* v. *Northern Utilities, Inc.*, 673 F.2d 323 (10th Cir. 1982)

United States District Court for the District of Wyoming: *Kerr-McGee Corporation* v. *Northern Utilities, Inc.*, 500 F. Supp. 624 (D. Wyo. 1980)

## JURISDICTIONAL STATEMENT

Review is sought of a decision of the United States Court of Appeals for the Tenth Circuit dated and entered on March 23, 1982. Order denying petition for rehearing dated June 14, 1982 and entered June 15, 1982.

Jurisdiction of this Court to review that decision by writ of certiorari is conferred by 28 U.S.C. § 1254(1).

## PERTINENT STATUTES

Section 34-21-219 of the Wyoming Statutes (1977). *Unconscionable Contract or Clause:*

> "(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
>
> "(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."

Section 34-21-103 of the Wyoming Statutes (1977). *Supplementary General Principles of Law Applicable.*

> "Unless displaced by the particular provisions of this act [§§ 34-21-101 to 34-21-1002], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." (Laws 1961, ch. 219, § 1-103.)

Section 105 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3315. *Ceiling Price For Sales Under Existing Intrastate Contracts.*

> "(a) APPLICATION.—The maximum lawful price computed under subsection (b) shall apply to any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any suc-

cessor to an existing contract, which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act.

"(b) MAXIMUM LAWFUL PRICE.—

"(1) GENERAL RULES.—Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—

"(A) the price under the terms of the existing contract, to which such natural gas was subject on the date of the enactment of this Act, as such contract was in effect on such date; or

"(B) the maximum lawful price, per million Btu's, computed for such month under section 102 (relating to new natural gas).

"(2) CONTRACT PRICE EXCEEDING NEW GAS CEILING PRICE ON ENACTMENT.—In the case of any natural gas described in subsection (a) for which the contract price applicable on the date of the enactment of this Act exceeds the maximum lawful price, per million Btu's, computed for such date under section 102 (relating to new natural gas), the maximum lawful price under this section shall be the higher of—

"(A) the maximum lawful price, per million Btu's, computed for such month under section 102; or

"(B)(i) the contract price on the date of the enactment of this Act, in the case of the month in which this Act is enacted; and

"(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

"(3) PRICE INCREASES RESULTING FROM INDEFINITE PRICE ESCALATOR CLAUSES.—

"(A) IN GENERAL—Effective January 1985, and each month thereafter, in the case of any first sale of natural gas, which is sold at a price established under any indefinite price escalator clause of any existing contract or successor to an existing contract and for which the contract price on December 31, 1984, is

higher than $1.00 per million Btu's, the maximum lawful price under this section for any such natural gas delivered during any month shall be the higher of—

"(i) the maximum lawful price, per million Btu's, computed under paragraph (2)(B); or

"(ii)(I) in the case of January 1985, the maximum lawful price, per million Btu's, computed under section 102 (relating to new natural gas) for such month; and

"(II) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this clause for the immediately preceding month multiplied by the monthly equivalent of the sum of a factor equal to the annual inflation adjustment factor applicable for such month plus .03.

"(B) DEFINITION OF INDEFINITE PRICE ESCALATOR CLAUSE.—For purposes of this paragraph, the term 'indefinite price escalator clause' includes any provision of any contract—

"(i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or

"(ii) which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

"(C) CONTRACT MODIFICATIONS AFTER MAY 3, 1978, TO BE DISREGARDED.—In the case of any natural gas which was subject to any contract on May 3, 1978, that contained an indefinite price escalator clause on such date, no amendment to or modification of the operation of such contract made after such date may have the effect of limiting or precluding the application of this paragraph on or after January 1, 1985, to prices allowed with respect to such natural gas.

"(D) EXCLUSION—Subparagraph (A) shall not apply to any first sale of new natural gas (as defined in section 102(c)), stripper well natural gas (as defined in

section 108(b)), high-cost natural gas (as defined in section 107(c)), natural gas produced from a new, onshore production well (as defined in section 103(c)) from a completion location located at a depth of more than 5,000 feet, and, beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 122, natural gas produced from any new, onshore production well (as defined in section 103(c)) from a completion location located at a depth of 5,000 feet or less.

"(c) DEFINITION OF CONTRACT PRICE.—For purposes of this section, the term 'contract price,' when used with respect to any specific date, means—

"(1) the price paid, per million Btu's, under a contract for deliveries of natural gas occurring on such date; or

"(2) if no deliveries of natural gas occurred under such contract on such date, the price, per million Btu's, that would have been paid had such deliveries occurred on such date."

## STATEMENT OF THE CASE

This is a petition to the United States Supreme Court for a Writ of Certiorari. Review is sought of a decision of the United States Court of Appeals for the Tenth Circuit which reversed a judgment entered by the United States District Court for the District of Wyoming. Jurisdiction of the district court was based on the diversity of citizenship among the parties and the requisite amount in controversy. 28 U.S.C. § 1332.

These consolidated cases concern the enforcement of an indefinite price escalator clause in three contracts for the intrastate sale of natural gas in Wyoming. The clause is designated Article 6(b) in all three contracts and is identical in each case. Petitioner, Northern Utilities, Inc. (hereafter "Northern"), is the purchaser of the gas under each contract. Respondents are the producers and the sellers of the gas under separate contracts; they are Amoco Production Company (hereafter "Amoco"), Kerr-McGee Corporation (hereafter "Kerr-McGee") and Phillips Petroleum Company (hereafter "Phil-

lips"). The central question presented is whether Article 6(b) is unconscionable under Section 2-302 of the Uniform Commercial Code as adopted in Wyoming or whether it is otherwise unenforceable as being against federal and state public policy.

On January 19, 1978, Kerr-McGee filed an action against Northern in the United States District Court for the District of Wyoming seeking to recover amounts allegedly owed by Northern but not paid and also seeking a declaratory order to establish the prospective application of Article 6(b). Northern answered, *inter alia*, that Article 6(b) was unenforceable, and filed actions in the same court asserting like claims against Amoco and Phillips. The three actions were consolidated.

On October 23, 1980, following a non-jury trial, the district court held that Article 6(b) was void and unenforceable on the grounds that it was contrary to public policy and unconscionable under Section 2-302 of the Uniform Commercial Code, Wyo. Stat. § 34-21-219 (1977). The Court excised Article 6(b) and ordered that the remainder of the contracts should be enforced. (Appendix A-4; hereafter findings and conclusions of the district court are cited by number). Under a supplemental judgment entered on November 20, 1980, the district court ordered the producers to repay Northern the sum of $67,758,567.43 plus interest. (Appendix A-5). Execution of the judgment was stayed pending appeal. The pleadings filed by Northern stated that any amounts repaid by the producers would in turn be refunded to customers of Northern.

The United States Court of Appeals for the Tenth Circuit entered a decision on March 23, 1982 which held that Article 6(b) is enforceable and that the clause is neither unconscionable nor contrary to federal or state public policy. (Appendix A-1).

The contracts in this case provide for the sale of natural gas produced from the Beaver Creek field in central Wyoming. All of the Beaver Creek gas production is purchased by Northern, forming about 85% of its total gas supply. (Findings 10 and 11). About 40% is resold to Amoco and its refinery affiliate, the balance being sold by Northern to domestic household and small commercial establishments under utility tariffs.

Only Amoco and Northern conducted face to face negotiations. Agreements entered into between them were copied or adopted by reference in later contracts between Northern on the one hand and Kerr-McGee and Phillips on the other. Subsequent discussion will refer only to the contract between Amoco and Northern unless otherwise noted.

All earlier agreements were superseded by the Gas Sales Contract entered into on November 20, 1957 (hereafter the "1957 Contract").[1] It provided for the sale of Beaver Creek gas over a twenty-year period. Northern was obligated to take, or pay for in any event, certain minimum annual quantities (hereafter the "take-or-pay" obligation). The 1957 Contract contained three price provisions. Article 5 set forth a fixed price schedule which escalated annually from 10.17¢ per thousand cubic feet ("Mcf") in 1959 to 20.81¢ per Mcf in 1978. Article 7 provided for an adjustment to that fixed price based upon inflation. Article 6, Favored Nations Clause, escalated the price payable under the 1957 Contract to equal the highest price paid by Northern to any other producer of gas in the State of Wyoming. In addition to the above price provisions, Article 16 provided for Northern to reimburse certain production related taxes. Another article of the 1957 Contract prohibited Northern from reselling Beaver Creek gas in interstate commerce. At the same time as the 1957 Contract was being negotiated, collateral agreements were entered into for the resale of a part of the Beaver Creek gas back to Amoco and to its refinery affiliate; the resale price was agreed to be a fixed margin per Mcf above the price paid by Northern for Beaver Creek gas. Kerr-McGee and Phillips were not parties to those collateral resale agreements.

On April 7, 1970, Amoco notified Northern that Beaver Creek gas reserves had been recalculated to exceed the quantities committed under the 1957 Contract. Amoco expressed its

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[1] Exhibit A-1; the Kerr-McGee contract is dated October 14, 1958, Exhibit B-1; and the Phillips contract is dated May 20, 1958, Exhibit C-1.

desire to sell the excess gas coextensively and invited Northern to negotiate for the purchase of that additional gas. (Exhibit A-6). A major renegotiation ensued which culminated in the execution of a number of separate instruments. Among these was a supplemental agreement dated October 1, 1970 (hereafter the "1970 Supplement").[4] It amends the 1957 Contract in a number of respects. (Finding 20). Except for the term extension, each represented a concession by Northern. The term of the contract was extended twelve years and two months to December 31, 1990. The annual take-or-pay obligation was increased from a ratio of 59% of the peak deliverability capacity of the Beaver Creek Field to a ratio of 92.7% of that capacity. The producers' delivery pressure obligation was reduced. Article 16 was amended to increase Northern's obligation to reimburse production related taxes. The fixed price schedule in Article 5 was amended to provide for prices during the extended term ranging from 21.81¢ per Mcf in 1979 to 29.8¢ per Mcf in 1990, representing slightly higher annual increases than had been the case under the 1957 Contract, all subject to adjustment for inflation. The 1970 Supplement further redesignated Article 6 to be paragraph (a) and adopted the price escalator clause here at issue as Article 6(b). That clause links the price to be paid under the contract to the price being paid for gas sold in interstate commerce. (Reprinted in Appendix A-7).

In addition to the 1970 Supplement, a number of collateral agreements were reached at the same time. They too were concessions by Northern. One provided for Northern to finance compression equipment for compressing Beaver Creek gas. (Exhibit A-9). The remaining collateral agreements principally concerned arrangements under which Northern sells gas to Amoco and its refinery affiliate. The fixed resale margins were retained. (Exhibits A-8, 10, 12 and 13).

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[4] Exhibit A-7; the Kerr-McGee supplement is dated February 23, 1973, Exhibit B-8; the Phillips supplement is dated May 4, 1973, Exhibit C-12.

Article 6(b) engendered no discussion between the parties from the time of its adoption in 1970 until a month before its effective date of January 1, 1976. (Tr. 295). Meanwhile, however, the Federal Power Commission had materially changed the manner in which it regulated the price of gas produced in Wyoming and sold in interstate commerce. While there had been but a single price for interstate gas in 1970, there were many categories of prices in 1976. The principal distinguishing feature among price categories was the year in which the gas was discovered, generally referred to as the "vintage" of the gas. Other criteria also affected the applicable price under Federal Power Commission regulations. For example, those persons who qualified as "small producers" were authorized to collect 130% of the otherwise applicable price. Also during this period, the Federal Power Commission changed its pricing unit from an Mcf basis to one based upon a million British Thermal Units. The basic thrust of the new Federal Power Commission policy was to set new gas prices markedly higher as an incentive to attract gas to the interstate market. Prices for old flowing gas were adjusted for inflation but remained relatively low. Consumers buying interstate gas were not adversely affected because the effect of the higher priced gas could be averaged or "rolled-in" with the much greater volume of old gas. (Tr. 549). With Beaver Creek accounting for 85% of Northern's supply, no cushion existed.

An important development occurred after this litigation was begun when the Natural Gas Policy Act of 1978 was enacted. 15 U.S.C. § 3301 *et seq.* ("NGPA"). Beginning December 1, 1978, Section 105 of the NGPA has imposed a maximum lawful price ceiling on Beaver Creek gas. That ceiling is the lesser of the price under the terms of the contract or the maximum lawful price determined monthly for "new" gas under Section 102 of the NGPA.

The producers elected to call no witnesses at trial and Northern called four. The principal two are:

1. *Arles H. Barrett.* Mr. Barrett has been employed by Amoco since 1946. His duties involved natural gas measurement until 1963 at which time he assumed duties

in contract negotiation. He was the individual through whom Amoco negotiated in 1970 with Northern. (Tr. 53 and 54).

2. *Edwin V. Magagna.* Mr. Magagna had been employed by Northern part-time since 1963 and full-time since 1971. He is an attorney and is the individual through whom Northern negotiated in 1970 with Amoco. (Tr. 260 and 347).

## ARGUMENT

### 1. SUMMARY.

The court of appeals below wholly ignored the entire body of evidence in this case which the unconscionability statute declares to be relevant: evidence of the commercial setting, the purpose and the effect of the particular bargain at issue. The clause in this case is unique. Unconscionability is intrinsic to its design, purpose and result. By stating a price in dimensionless terms, it adopts by reference a third party's dollar and cents price which on its face is higher, but which in fact is not. The producers intended the clause to utilize no conversion factor to adjust for differing measurement base, differing heat content (Btu), differing tax assessments, and as emphatically as all, the producers here, among the largest in the United States, ask to be paid new gas prices for old gas plus the small producer bonus.

The clause was adopted in 1970 when the producers reopened an existing contract in order to foreclose Northern from buying cheaper gas which was then available. Amoco and the other producers secured a long list of one-sided concessions from Northern whose only benefit was an extension of the term, and even that was mutually beneficial. The lever to reopen the contract was Amoco's threat to sell freshly recognized Beaver Creek reserves to an interstate purchaser coextensively with continuing sales to Northern under the existing contract, a circumstance which would have placed Northern's principal gas supply in jeopardy. Article 6(b) was peripheral to the central concessions. The threat of a coextensive interstate sale misled Northern to accept that the clause

was intended only to insure that the price under its contract should always be 3¢ above the price at which Beaver Creek gas could have been sold in interstate commerce at that time.

Application of the clause has resulted in the resale of 40% of the gas back to Amoco and its refinery affiliate to be a service rendered by Northern at a loss. The remaining gas is sold by Northern to residential and small commercial consumers who have stood aghast as the Beaver Creek price spiraled upward by ten-fold over a four year period and their gas bills increased accordingly. The public interest in this case speaks correspondingly loud. The unconscionability of this clause should be redressed. Certiorari should issue.

## II. UNCONSCIONABILITY.

The court of appeals below chose to view the record as one presenting the simple case of a rising market price which neither party could foresee at the time of the adoption of Article 6(b), a clause which the court reasoned was knowingly accepted by Northern as the *quid pro quo* for assuring a long term gas supply. Such is not the case. Unconscionability arises from the facts of record, facts which the court of appeals overlooked and did not consider. In doing so, the court of appeals has so far departed from the accepted and usual course of review as to call for an exercise of this Court's power of supervision.

Unconscionability is a common law concept akin to equity which dates from at least 1663. Now codified in Wyoming, which adopted the Uniform Commercial Code provision without modification, the beginning point of inquiry must be the language of the statute itself. Section 2-302 of the Uniform Commercial Code, Wyo. Stat. § 34-21-219 (1977).

Evidence describing the "commercial setting" in which the contractual provision was adopted, evidence disclosing the "purpose" which the parties intended the provision to fulfill and evidence adducing the "effect" which the provision has had are the three elements which the statute itself declares are designed "to aid the court in making the determination. The

statute, therefore, can be seen to describe unconscionability as a legal result which flows from the particular commercial setting, purpose and effect of a contractual provision. Unconscionability flows from the facts.

**1. The Language Of Article 6(b) Was Entirely Drafted By Amoco And Is "Unique"; It Was Purposefully Crafted To Be "Definitely Indefinite".**

Mr. Barrett conceived the substance of the clause and Amoco's legal staff drafted the language under his direction. (Tr. 160). Mr. Barrett testified that Northern's representative had no input at all into the language of the clause. (Tr. 228). The resulting language was unique. It is like no other favored nations clause in Wyoming. Mr. Barrett so testified: "It is unique to this contract. It is unique to contracts as a whole in Wyoming." (Tr. 161). He explained what makes it unique:

> A. Because it is definitely indefinite as to price. It is the highest price paid. Very often third party favored nations provisions do have some limitations.

(Tr. 231).

Article 6(b) was framed in language so indefinite that the resulting price has no reasonable limit. Amoco intended that there should be no reasonable limit, and Kerr-McGee and Phillips have adopted that meaning as their own.

**2. Amoco Intended That Article 6(b) Should Adopt A Nominally Higher "Price" By Reference To A Third Party Sale Without Proper Adjustment For Differences In Measurement Factors.**

It is self-evident that a price denominated in dollars per gallon must be adjusted before comparing it to one denominated in dollars per quart. A conversion must be made. The nominal price per gallon must be divided by 4 to properly reflect the price per quart. In adopting a third party's price by reference, Amoco intended that Article 6(b) should be subject to no such conversion.

Natural gas is measured on a volumetric basis in units of one thousand cubic feet, an Mcf. As a compressible fluid, however, the amount of gas contained in an Mcf is directly proportionate to pressure. The higher the pressure, the more gas there is in an Mcf. (Tr. 552). No single pressure base has ever become universally accepted as standard in the natural gas industry. Article 12 of the Beaver Creek contract specifies that gas is to be measured at a pressure base of 15.025 psia. Federal regulations employ different pressure bases. (Tr. 542 and 552).

Frank H. Houck was a member of the legal department of Amoco who took part in drafting the language of Article 6(b). (Tr. 163). His meaning of the clause is memorialized in an internal Amoco memorandum addressed to Mr. Barrett's immediate superior: "pressure base adjustments are not material. If a producer receives, say, 72¢ per MCF (regardless of pressure base), Amoco is entitled to collect 75¢ per MCF (regardless of pressure base)." (Exhibit I-30, parenthetical remarks in original.) In his testimony, Mr. Barrett made clear that he concurred with Mr. Houck that no pressure base factor should be used.

> Q. And you don't compare the price pressure base and compare it to Beaver Creek pressure base?
>
> A. That is not what Article 6(b) provides.
>
> Q. Well, is that what you have been doing?
>
> A. Oh . . . . Amoco is really accepting a lesser price than it is entitled to receive under Article 6(b).

(Tr. 189).

A "price" clause which specifies no unit of measurement is a license to steal. It is manifestly unconscionable.

### 3. Amoco Intended Article 6(b) To Serve As A Mechanism To Charge For More Btu's Than Beaver Creek Gas Contains.

The heating value of natural gas is measured in British Thermal Units ("Btu's"). Experienced in gas measurement, Mr. Barrett was able to define a British Thermal Unit at trial

from his own knowledge without reference to any text: "Btu is the amount of heat energy necessary to raise one pound of water one degree from 58.5 to 59.5 degrees Fahrenheit." (Tr. 55). He recognized that high Btu gas is priced higher in the market place than is low Btu gas. (Tr. 56). He testified that "Beaver Creek gas is processed" to remove "propane, butane and gasoline", a fact which reduces the Btu content of the naturally occurring gas. (Tr. 218). Mr. Barrett was emphatic, however, that Article 6(b) was intended to escalate the Beaver Creek price to the high price level received by a seller of rich Btu gas. He would "diligently search" for the highest Btu gas sold in interstate commerce because "I would like the contract implemented to the fullest." (Tr. 219). Mr. Barrett testified that no Btu adjustment was intended to be made by Article 6(b) before applying the third party's "price" for gas having a higher Btu value than Beaver Creek gas.

Q. And then do you compare his Btu to Beaver Creek Btu and make an adjustment for that?

A. Absolutely not. (Tr. 198 and 199).

A letter agreement entered into between Amoco and Northern on June 25, 1976, just six months after Article 6(b) became effective, sets forth the technical details necessary for measuring the Btu value of Beaver Creek gas. A recital describes the purpose of this measurement: "Currently it is necessary to determine the gross heat content of the gas delivered under the contract to compute the price for such gas." (Exhibit I-26). Mr. Barrett, however, categorically denied that the necessity for measuring the Btu of Beaver Creek gas at that time had anything to do with Article 6(b). (Tr. 84 through 91).

All persons except Mr. Barrett seem to have misinterpreted the letter agreement. Amoco, Kerr-McGee and Phillips withdrew their original Exhibits 11, 12 and 13. With leave of court, they filed substituted exhibits after the trial. The original exhibits were based on the actual Btu's contained in Beaver Creek gas. (Tr. 247). The substituted exhibits reflect the higher Btu's contained in various third parties' gas sold in interstate commerce. For the period January 1, 1976 through

November 30, 1978, this additional Btu claim alone amounts to more than $4.2 million. (Substituted Exhibits 11, 12 and 13).

In reaching out to be paid for more Btu's than are delivered, Article 6(b) has reached too far. It has reached unconscionable proportions. Purveyors of gasoline may not in conscience charge for high-octane ethyl when they only deliver regular.

**4. Amoco Intended Article 6(b) To Reach Out For The Reimbursement Of More Production Taxes Than Are Paid On Beaver Creek Gas.**

Relying on Article 6(b), the producers ask to be reimbursed for more production taxes than are actually paid by them on Beaver Creek gas. Article 16 of the 1957 Contract obligates Northern to reimburse a part of the production tax paid on Beaver Creek gas. According to Mr. Barrett, Article 6(b) supersedes that provision and requires Northern to pay Amoco an amount per Mcf equal to the tax reimbursement received by a producer for gas sold in interstate commerce. But no two producers in the State of Wyoming pay the same tax. Severance and conservation taxes depend on the amount of exempt government royalty. (Tr. 250 and 481). Ad valorem taxes are assessed by local government units and consequently vary from one county to another, and within a county, from one school district to another. (Tr. 251 and 252). Mr. Barrett testified that tax reimbursement under Article 6(b) should be treated in the same manner as pressure base and Btu. (Tr. 217 through 219). A "diligent search" should be made to identify the highest taxed school district and the producer with the least government exempt royalty because "I would like the contract implemented to the fullest." (Tr. 219). The producers' original Exhibits 11, 12 and 13 asked to be reimbursed only the taxes actually paid on Beaver Creek gas. (Tr. 251). Conforming their exhibits to the testimony of Mr. Barrett, the producers Substituted Exhibits 11, 12 and 13 ask to be paid more than three-quarters of a million dollars simply because various higher taxed producers were identified.

**5. The Lever Employed By Amoco To Reopen The 1957 Contract Misled Northern To Believe That Article 6(b) Merely Provided For A Nominal 3¢ Premium Over The Price At Which Beaver Creek Gas Could Be Sold In Interstate Commerce.**

It became apparent to Amoco in early 1970 that other gas supplies were becoming available and that Northern "is able to obtain gas under such commitments at prices less than our Beaver Creek price (15¢ Mcf vs. 17.4¢ Mcf)." (Exhibit I-6). Amoco determined to foreclose Northern from contracting for those supplies.

If the Beaver Creek take-or-pay obligation could be raised sufficiently high, Northern would have no capacity left to purchase gas from others. The annual take-or-pay obligation is directly proportional to the peak daily deliverability under Exhibit B to the contract. Amoco initially focused on improving deliverability. In January of 1970, Amoco related to the other two producers by letter that such steps should be taken.

> "We feel that new gas supply sources will be available to NUI over the next four years. Such an atmosphere warrants that every effort be dedicated toward meeting the deliverability requirements of the Contract to sustain the current minimum obligation. (Exhibit I-4).

But sustaining the take-or-pay obligation by maintaining deliverability is expensive. The expense could be avoided if Northern could be persuaded to make the necessary concessions. It could. Northern amended the contract to reduce the delivery pressure requirement (Exhibit A-7, Paragraph 6), financed $1.2 million worth of compression equipment (Exhibit A-9) and increased the take-or-pay obligation from a ratio of 59% of the peak deliverability capacity to a ratio of 92.7% of that capacity (Exhibit A-7, Paragraph 3; Tr. 266).

The lever to reopen the contract was found in Article 8(d). It permitted coextensive sales of Beaver Creek gas to third parties. All that was needed was a sufficiently high gas reserve estimate. Amoco commiasioned an in-house study which reached the desired conclusion. (Exhibit I-5). "Armed with your recent reserve study" Mr. Barrett wrote in an internal

Amoco memorandum, "we commenced to negotiate." (Exhibit I-6). The author of that reserve study wrote that Mr. Barrett would also "attempt to use the Beaver Creek situation as a lever to obtain concessions which would help us in other fields," those fields principally being the points where Northern resells gas back to Amoco. (Exhibit I-7). The lever was applied in a letter inviting Northern to negotiate for the purchase of the freshly recalculated reserves. (Exhibit A-6). Mr. Magagna was told that Amoco was prepared to coextensively sell Beaver Creek gas to an interstate purchaser. He testified:

> "When we were negotiating in 1970 we were talking about whether they were selling gas to us in 1970 or to somebody else in 1970. Now as far as we knew the only purchasers available to buy it in 1970 was interstate purchasers." (Tr. 403).

Mr. Barrett testified, however, that Amoco in fact had no such intention.

> Q. . . . . Did you compare the prospective NU deal with another deal to a buyer who would be an interstate purchaser?
>
> A. I did not . . . . [M]y intent was to sell the gas to Northern.

(Tr. 141).

An internal Amoco document prepared in 1970 expresses the company's reservations respecting its right to sell Beaver Creek gas coextensively. (Exhibit I-19). Another internal Amoco document prepared in 1970 declares that the reserve study was simply the prerequisite necessary to present Northern with a shopping list of concessions. "Such additional reserves opened the door to amend the Beaver Creek Gas Sales Contract, and the presence of interstate gas purchasers in the area give weight to the concessions." (Exhibit I-21).

Although Amoco never seriously considered coextensively selling Beaver Creek gas to an interstate pipeline, that possibility opened the door to amend the contract and gave weight to the concessions it sought. It is that lever which misled Northern into believing that Article 6(b) was meant to provide

a 3¢ premium over what Amoco would have received if it had coextensively sold the gas to an interstate pipeline. Mr. Magagna testified that in discussing Article 6(b) in 1970, he and Mr. Barrett "were trying to come up with an answer . . . [to] what we were going to pay in order to have it sold to us, in lieu of being sold to somebody else." (Tr. 420). The following excerpt reflects the understanding of Mr. Magagna respecting negotiation of Article 6(b).

> A. Well, the best that I can recall that it come up that intrastate gas was being sold at a premium. And at this point that they had this gas to sell, and that they wanted to be sure that they were getting a premium over what they could get for this gas, were they to sell it in interstate commerce under the regulations, and they wanted to be sure that whatever the regulated price would be that they would be entitled to get, had they sold that, that they wouldn't wind up and say, "Well, you made a mistake, you should have sold this gas in interstate commerce because you have a better deal."
>
> Q. And then when you saw what became the forerunner of the present 6(b), was there more discussion about what that would do or whether that would accomplish what you had discussed?
>
> Tell us what the discussion was.
>
> A. No, other than it made the discussion about the amount. After it got written with the 3 cents in, I don't think that we had much to discuss about it. We didn't discuss it further.

(Tr. 286 and 287).

Every detail of the origination of Article 6(b) was examined at trial; a disproportionate share of argument is devoted to that subject. The inference may be created that this clause was central to the 1970 contract netotiations. It would be a false inference. Although some issues were "kicked back and forth" (Tr. 280) and the negotiators "hemmed and hawed around" on others (Tr. 279), Article 6(b) was a peripheral concession to which little time or though was given.

Amoco included no such clause in its initial draft of the supplemental agreement. (Exhibit I-8). No such clause was proposed to Northern until the "third or fourth" meeting between the parties. (Tr. 276). Internal economic evaluations of the supplemental agreement made by Amoco were based entirely on the inflation adjusted fixed price schedule. (Exhibit I-11; Tr. 167). More negotiating time was devoted to the compression financing arrangements than to any other issue. (Tr. 273). So far as Article 6(b) itself was concerned, its effective date was discussed (Tr. 285) and two counties were excluded from its reach. (Tr. 293). Messrs. Barrett and Magagna both testified, however, that the only substantive discussion about the clause concerned the amount of the premium; it was quickly reduced from the initially proposed 5¢ to 3¢ and they turned their attention to other matters. (Tr. 229 and 277).

After all negotiations with Northern were completed, Amoco worked the supplemental agreement through its management committee system for approval and execution. When it reached the general office for final approval, a written presentation was prepared. (Tr. 178). It discusses a number of Northern's concessions, but "basically" the supplemental agreement is characterized as being "a decrease in the peak deliverability . . . in exchange for an extended term." (Exhibit I-19). Respecting price, the fixed price schedule of Article 5 is set forth in detail and the inflation adjustment under Article 7 is noted. But nowhere does that written presentation make reference to Article 6(b).

Northern had a presentation to make as well. A seven page statement was made when the various agreements were filed with the Wyoming Public Service Commission. Eight separate instruments were submitted for filing and each was summarized. The supplemental agreement containing Article 6(b) was described in these words:

> "This extends term to 12-31-1990, provides base price for years 1979 to 1990 inclusive, amends delivery rates, re-

duces delivery pressure, and provides for reimbursement for all additional taxes." (Exhibit A-15).

Like the general office of Amoco, Northern, too, so misapprehended the reach intended by Mr. Barrett for Article 6(b) that the clause was not mentioned in its presentation.

**6. The Resale Of 40% Of Beaver Creek Gas Back To Amoco Is Transformed Into An Operating Loss For Northern By Operation Of Article 6(b).**

Northern is obligated to resell about 40% of Beaver Creek gas back to Amoco and its refinery affiliate, with the refinery accounting for the preponderance of that quantity. (Tr. 233). Northern purchases the gas at Beaver Creek; transports it a hundred miles or more and resells the gas back to Amoco at a fixed margin above the Beaver Creek price, 5 cents per Mcf in the case of the refinery. (Tr. 210). One expense of transportation, termed a "line loss", represents the fact that less gas is delivered from a long transmission pipeline than is received. Northern experiences an average line loss equal to 2% of the volume handled. (Tr. 317). The expense varies directly with price, and at the Article 6(b) price at the time of trial, $2.80, the 2% line loss amounts to 5.6 cents per Mcf, more than consuming the entire 5¢ per Mcf margin. (Tr. 319). In contrast, the Article 5 price for the same period would have been just under 60 cents, after the inflation adjustment provided for in the contract. (Exhibit F). That price would have resulted in a line loss expense of less than 1.2 cents per Mcf. Northern's loss arises directly from the one-sided application of Article 6(b) to the purchase side of the transaction. A wholesaler who has required his retailer to transport and resell 40% of the goods back to him, at a loss, has struck a bargain too far unbalanced to leave stand.

* * * * * * * * * * *

Do the foregoing facts establish unconscionability? They are at least relevant considerations. Certiorari should be granted because the court of appeals completely ignored these facts.

The unconscionability provision of the Uniform Commercial Code is the law which declares these facts to be relevant. They evidence the commercial setting, the purpose and the effect of Article 6(b). But do the facts of this case rise to unconscionable proportions? The legislative history of the statute must be consulted and analogies to the common law must be drawn. "Unless displaced by the particular provisions of this act, the principles of law and equity . . . shall supplement its provisions." UCC Section 1-103, Wyo. Stat. 34-21-103 (1977).

The earliest reported unconscionability case involved assumpsit on a horse. The defendant had agreed to buy at a price equal to one barley corn per nail in the horse's shoes, doubling the amount with each nail. The horse had 32 nails in its shoes which led to a price of 500 quarters (4,000 bushels) of barley, a patently exhorbitant price of 100 pounds sterling. Chief Justice Hyde directed the jury to give the value of the horse, 8 pounds sterling, in damages. *James* v. *Morgan*, 1 Lev. 111, 83 Eng. Rep. 323 (1663). Another early English court refused to enforce an unconscionable quantity clause. In consideration of a nominal sum of money, the defendant had agreed to deliver two grains of rye on a certain Monday and to double that quantity on successive Mondays for a year. The astronomical quantity of 524,288,000 quarters of rye had been demanded at trial. *Thornborow* v. *Whitacre*, 2 Ld. Raym. 1164, 92 Eng. Rep. 270 (1705). It is noteworthy that these cases both involved the sale of goods. Both involved oppression and unfair surprise, as relates to price in the one and quantity in the other. The surprise manifests itself in that the aggrieved party would not have accepted the unconscionable provision if the outrageous sum generated by it had been expressed in direct terms instead of being obfuscated.

These two cases "were plainly cases in which one party took advantage of the other's ignorance of arithmetic to impose upon him." *Hume* v. *United States*, 132 U.S. 406, 413 (1889). Transplanting the principles developed in England, *Hume* became the leading American case on unconscionability. The facts in *Hume* involved a contract under which the plaintiff agreed to sell shucks to the government at a price of 60¢ per

pound. The government answered that the price of 60¢ was meant to be denominated in units of hundredweight. A mistake had been made in the printing. But the plaintiff testified that there was no mistake on his part; he intended to bid 60¢ per pound and that is what the contract said. Evidence was introduced in the trial to establish that the value of shucks ranged from 3/5¢ per pound to 1-3/4¢ per pound and that the custom of the government was to purchase shucks by the hundredweight. The court announced the proposition that "if a contract be unreasonable and unconsionable, but not void for fraud, a court of law will give to the party who sues for its breach damages, not according to its letter, but only what he is equitably entitled to." *Id.* at 413. The *Hume* court adopted a definition of unconscionability which has been often cited. An unconscionable bargain is one "such as no man in his senses and not under delusion would make, on the one hand, and as no honest and fair man would accept, on the other." *Id.* at 411. That is the definition of unconscionability which has been adopted in Wyoming. *In re Estate of Frederick*, 599 P.2d 550, 556 (Wyo. 1979).

When the law governing the sale of goods was codified in the Uniform Commercial Code, the common law heritage respecting unconscionability was preserved by the draftsmen. "The basic test is whether . . . the clauses involved are so one-sided as to be unconscionable . . . . The principle is one of the prevention of oppression and unfair suprise." Uniform Commercial Code, Official Comment to § 2-302, American Law Institute (1962). (Reprinted in Appendix A-6). The comments reference eleven cases in all. *Campbell Soup Co.* v. *Wenz*, 172 F.2d 80 (3rd Cir. 1948) is cited in the text. Ten others are set forth in a list.

Unfair surprise is one test suggested in the comments. The test looks for some indicia of surprise: a gasp, a skipped heartbeat or a dropped jaw perhaps. Material variations from what a contracting party was lulled into expecting produce surprise. Obviously relevant is whether the implications of the clause should have been pointed out especially, or explained, or at the very least not hidden in verbal complexity. The test might be

stated: if the clause had been understood, would it have been accepted? Through the artifice of threatening to sell Beaver Creek gas coextensively to an interstate purchaser, Amoco lulled Mr. Magagna into believing that Article 6(b) merely provided for a 3¢ premium over the price that Amoco could receive for Beaver Creek gas in an interstate sale. Would Mr. Magagna have accepted the clause if he had known that Mr. Barrett intended there to be no adjustments for pressure base or Btu?

The negotiations of the various contracts in 1970 spanned some six months. The negotiators focused on other issues. Reducing the originally proposed 5¢ premium to 3¢ was about the only objection that Mr. Magagna had to Article 6(b). He would have been surprised if he had understood that the 2¢ reduction is hardly worth two cents amidst the diverse implications of Mr. Barrett's "definitely indefinite" and "unique" clause. When a single clause, little bargained over, virtually destroys the other terms and provisions of the package which were deliberately bargained for, unfair surprise is evidenced. A peripheral clause cannot be permitted to defeat the heavily dickered terms of an agreement. *Zabriskie Chevrolet, Inc.* v. *Smith*, 240 A.2d 195 (N.J. 1968). If the drafting party raised expectations contrary to the writing, unfair surprise is manifest, and if the result is harsh and oppressive, the clause is conconscionable and will not be enforced. *State ex rel Lefkowitz* v. *ITM, Inc.*, 275 N.Y.S. 2d 303 (Sup. Ct. 1967). And no clause "[m]ore intimately touches upon the question of unconscionability than does the term regarding price." *Jones* v. *Star Credit Corp.*, 298 N.Y.S.2d 264, 266 (Sup. Ct. 1969).

These results do not depend on the nature of the parties involved. Unconscionable clauses cannot be transformed into conscionable ones by the supposed sophistication of the parties. The list of ten cases in the official comments to Section 2-302 dispels the notion that unconscionability is a remedy limited to bailing out illiterate or dull-witted consumers. All ten arise in commercial transactions and more than half involve dealings between merchants. "The parties are not notably old

or young, bright or stupid, drunk, needy or sick. None of the cases involves sailors, women, heirs or other presumptive incompetents. There is no flavor of fraud or duress in any individualistic sense." Leff, *Unconscionability and the Code - The Emperor's New Clause*, 115 U.Pa.L.R. 485, 502 (1967).

The president of a canning company who carelessly signed a deceptively arranged contract was relieved from its obligations because he had not appreciated that the document he executed was in fact a contract. The unfair surprise arose from the manner in which the document was folded, the type of printing and the arrangement of the contents. *International Transportation Association* v. *Atlantic Canning Co.*, 249 N.W. 240 (Iowa 1933). The "circuitry of language" itself can impart misleading expectations in the non-drafting party which give rise to unfair surprise when the actual effect of the clause is learned. *Otto Baedeker & Associates, Inc.* v. *Hamtramck State Bank*, 241 N.W. 249, 250 (Mich. 1932). The record in this case clearly establishes that the contrived language of Article 6(b) did in fact mislead Mr. Magagna:

> Q. Are you saying that you say that what should be read into there is that the gas has to be under like conditions and circumstances; is that right?
>
> A. In effect, we have argued here that the BTU should be based on Beaver Creek BTU. Mr. Barrett gets up and says, "No, that's not true." I say that it is based on the contract of similar vintage gas. He gets up and says, "No." So I mean that is where our differences are.

(Tr. 407).

By admitting of no comparability standard for Article 6(b), the producers have clearly reached too far. Comparability is essential in a favored nations provision:

> "[C]omparability clauses govern determination of whether a dollar and cents price, greater on its face, is actually higher when pertinent factors of the two transactions are compared. . . . [I]t is the actual comparative values which must determine the true relationship of

prices as being higher, equal or lower." *Pure Oil Co.* v. *Federal Power Comm'n*, 299 F.2d 370, 373 (7th Cir. 1962).

Similarly, the threat of a coextensive sale in interstate commerce gave rise to a presupposition that Article 6(b) would merely provide a 3¢ premium over what Beaver Creek gas could have fetched if it had been sold in interstate commerce at that time. Mr. Magagna's only possible competitors in any coextensive sale were interstate purchasers. (Tr. 403). To purchase the gas for Northern, he had only to pay Amoco a 3¢ premium over the interstate price. This principle is recognized in a case much like the one at bar. *Amoco Production Co.* v. *Western Slope Gas Co.*, 535 F.Supp. 1305 (D. Colo. 1982). It involves on the one hand an intrastate gas utility, Western Slope Gas Company and its negotiator, Mr. Valenta, and on the other a producer and seller of gas, Amoco Production Company and its negotiator, Arles H. Barrett. The court found:

> "I accept the testimony of Mr. Valenta and reject the testimony of Mr. Barrett . . . . Western Slope knew that all it had to do to make the purchase was to meet or perhaps better just a little bit the price Amoco could get for its gas sold to one of the interstate pipelines." *Id* at 1308.

The clause at issue in *Amoco* v. *Western Slope*, of course, is entirely different language from that involved here. But the principle is analogous:

> "I have not the slightest doubt that . . . the purpose . . . was to be sure that the intrastate sale by Amoco to Western Slope would be protected by any vintage sections of the then proposed law which applied to gas sold in interstate commerce. Although Mr. Barrett said that such was not the intention of Amoco, . . . . Mr. Barrett's claim . . . was less than convincing." *Id.* at 1307-08.

Beyond unfair surprise, one-sidedness is another test proffered in the official comments, and oppression, the third test, contributes a sense of harsh and burdensome conditions. The case cited in the text of the comments principally relied on the concept of oppressive one-sidedness. The court regarded the

sharp bargain which had been struck to be "carrying a good joke too far." *Campbell Soup Co.* v. *Wenz*, *supra*, at 83. The defendant, a farmer, had agreed to sell carrots to the Campbell Soup Company under a written contract at a price of $30 per ton. He sold them instead on the open market at $90 per ton and Campbell sued to enforce the contract. Every provision was one-sidedly weighted in favor of Campbell. The one deemed by the court to be the hardest excused Campbell from accepting carrots under certain circumstances but did not permit the farmer to sell his rejected carrots elsewhere unless Campbell permitted him to do so. The court refused to enforce the contract because "it is too hard a bargain and too one-sided an agreement to entitle the plaintiff to relief in a court of conscience." *Id.* at 83.

Combining unfair surprise and one-sidedness, Karl N. Llewellyn, chief reporter and draftsman of the Uniform Commercial Code, intended unconscionability to police against clauses which are "too far unbalanced to be regarded as a background reasonably presupposed." Llewellyn, *Common-Law Reform of Consideration: Are There Measures?*, 41 Colum. L. Rev. 863, 871 (1941). Unconscionability looks for too much of something on one side of a scale.

Northern's transportation obligation is certainly one-sided. An agreement which gives rise to a loss on the resale of 40% of the goods back to the initial seller is so one-sided as to be a "cake sliced 99-1", to again use the words of Professor Llewellyn. 21 *American Law Instituted Proceedings*, 144 (1944). Mr. Barrett in this case wanted all of the cake:

> Q. Then you say at the time the contract was negotiated, and still now, it was your opinion and intention to contract for the highest possible price that anybody might receive for gas sold in interstate commerce regardless of its quality, its location, its Btu content, or any special value it might have or special prices it might have by virtue of applying FPC practices or the provisions of the Natural Gas Policy Act?

A. The Beaver Creek contract required payment on an Mcf basis, not on a Btu basis, so the answer to your question is yes.

(Tr. 219).

He wanted everything, without regard to anything. "There wasn't any doubt in my mind, Mr. Brown, but it would become the highest possible price being paid to any producer in the State of Wyoming." (Tr. 202).

Q. No matter what the basis was for permitting that highest price to be paid as compared to Beaver Creek gas?

A. True.

(Tr. 202).

Can this case be said to present anything except an oppressively one-sided bargain? The renegotiation of the contract in 1970 was nothing but a string of concessions on the part of Northern. (Finding 20). The take-or-pay obligation was increased so high that Northern had no capacity left to purchase cheaper gas from others which was in fact then available. (Tr. 513 and 514). And like the farmer who could not sell rejected carrots to someone else without the permission of Campbell Soup Company, the contract in this case prohibits Northern from dumping the high priced Beaver Creek gas in an interstate sale. (Exhibit A, Article 3). And like the seller of shucks who testified that he had made no mistake, that he had intended to bid 60¢ per pound and not per hundredweight, Mr. Barrett in this case testified that the so-called "price" to be adopted in Article 6(b) did not depend on whether it was based on one pressure base or another, and it did not depend on whether the third party's gas was rich in Btu or poor, except that he would "diligently search" for the richest Btu gas because it would lead to a higher Beaver Creek price. (Tr. 219). And the same holds true for tax reimbursement. (Tr. 217 through 219). And Mr. Barrett intended no less result concerning vintage, where he asks to be paid new gas prices for old gas, and where he asks to be paid the small producer bonus for

Amoco Production Company, one of the largest oil companies in the world.

## III. PUBLIC POLICY

### A. Wyoming Public Policy

The public policy of a state may be found in its "constitution and statutes and when they have not directly spoken, then in the decisions of the courts and in the regular practice of government officials." *Taylor* v. *State*, 612 P.2d 851, 865 (Wyo. 1980) (Rooney J. concurring). The regular practice of the Attorney General is to appear in cases in which the public interest is affected. Through that office, the State of Wyoming participated in this case as *amicus curie*. Wyoming joined with Northern in asking the district court to find Article 6(b) to be void. It joined in asking the court of appeals to affirm that action. That is the expressed public policy of the State of Wyoming in this particular case.

An authoritative history of indefinite price escalator clauses notes that "such clauses are themselves distinctly out of favor." 4 *Oil and Gas Law*, Williams, 1977, Section 726, Customary Provisions of Contract: Escalation Clauses. Section 726.1, page 763. "There is substantial evidence that in design and function" indefinite price escalator clauses "are 'incompatible with the public interest'." *Permian Basin Area Rate Cases*, 390 U.S. 747, 783 (1968). Clauses which are not favored at law are strictly limited unless they are shown to be reasonable under the particular facts and circumstances of the case. *Keller* v. *California Liquid Gas Corp.*, 363 F.Supp. 123, 126-127 (D. Wyo. 1973). Belonging to a class which is generally disfavored, Article 6(b) should not be enforced because there is nothing to save it in the particular facts and circumstances of record here. The "unique" clause in this case, which admits of no adjustment for proper measurement factors even, cannot be said to further public policy. Language which was deliberately crafted to be "definately indefinite" and at odds with the meaning instilled in the non-drafting party is not in the public interest. A clause which enables the seller to have 40% of the

goods transported and resold back to him at a loss to the buyer cannot be said to express public policy.

The public interest in this case, however, extends beyond the private pain suffered by Northern. Representing 85% of Northern's gas supply, the ten-fold increase in the price of Beaver Creek gas over a four-year period has translated into an unexpected hardship on consumers. "For the consumer a monthly gas bill of $30 has been increased to approximately $250 and is still increasing under clause 6(b) as claimed by the producers." (Finding 47). This increase stretches the price to several orders of magnitude above the fairly negotiated price schedule contained in Article 5, even after inflation adjustments permitted by Article 7. "Considering these circumstances, the contract is one that could result and did result in extreme hardship to the public." (Finding 45). "Contracts cannot be used as a 'device to hoodwink the law'." *TriCounty Electric Association, Inc.* v. *City of Gillette*, 584 P.2d 995, 1004 (Wyo. 1978).

The meaning of the public interest is disclosed in such cases as *Riddley* v. *Kraut*, 180 P.2d 124 (Wyo. 1947). The court in that case refused to enforce a written covenant not to compete in the business of repairing mechanical equipment. "Persons who are in need of such repair work ordinarily need or want it done promptly and it is in the public interest that their desires and needs to be fulfilled." *Id.* at 133. How much more in the public interest must be the sale of natural gas, a necessity of life for heating?

> "[I]t would seem that the character of service may be taken into consideration . . . . The sale and furnishing of lumber, for instance, stands on a different footing from the sale and furnishing of electricity under certain conditions. We may infer a public service in the one case when we would not in the other." *Rural Electric Co.* v. *State Board of Equalization*, 120 P.2d 741, 747, reh. den. 122 P.2d 189 (Wyo. 1942).

The court of appeals below discerned two reasons why Article 6(b) was compatible with the public interest of the State of Wyoming. The first was that the Wyoming legislature has not

enacted any restriction. And second, the court relied on a single decision by the Wyoming Supreme Court. Taking these matters in order, it will be seen that neither controls here.

When the legislature has not spoken, public policy may be adduced from "the decisions of the courts and in the regular practice of government officials." *Taylor* v. *Smith*, *supra* at 865. "Whether a contract is against public policy does not depend solely upon any local statute." *Fidelity & Deposit Co. of Maryland* v. *Grand National Bank of St. Louis*, 69 F.2d 177, 180 (8th Cir. 1934). The inherent powers of a court stand independent from enactments of a legislature. Public policy turns in large measure on the peculiar facts and circumstances of a particular case and is therefore a concept which is not conducive to codification. For five years, the Federal Power Commission asked Congress to proscribe indefinite price escalator clauses. Despite that Congress did not act after the proposal had been placed before it, the inherent power of the Commission was not diminished.

> "The fact that Congress was unwilling to set aside, by statutory fiat, existing price escalation clauses, has no tendency to establish that the Commission did not already have power to deal with the problem . . . ." *Superior Oil Co.* v. *Federal Power Comm'n*, 322 F.2d 601, 618 (9th Cir. 1963).

The other ground relied on by the court of appeals below is an opinion of the Wyoming Supreme Court. *Amoco Production Co.* v. *Stauffer Chemical Co.*, 612 P.2d 463 (Wyo. 1980). It held that the clause there presented did act to raise the contract price to that of the newest vintage of gas sold in interstate commerce. But that case is not determinative here. The *Amoco* v. *Stauffer* court itself offered that it might have reached a different result except that the parties had "specifically stipulated" that the newest vintage was "generally applicable", a precondition required by the clause. *Id.* at 466. The clause in that case is different from the one at bar in a number of other respects as well. The parties in *Amoco* v. *Stauffer* agreed that their clause was clear and unambiguous. *Id.* at 465. It included

adjustments for heating value (Btu) conversion, and it did not apply in the event of deregulation. *Id.* at 464. Furthermore, *Amoco* v. *Stauffer* dealt with a private contract between two Fortune 500 companies. This case concerns residential consumers for whom Beaver Creek gas is their only source of heat.

*Amoco* v. *Stauffer* is a contract interpretation case and not one involving public policy. Although, as the court of appeals below noted, a certain amount of argument pertaining to public policy may have been included in the briefs of the parties, public policy is not addressed in the *Amoco* v. *Stauffer* opinion. Deciding that an indefinite price escalator clause may act to escalate the contract price as a matter of contract interpretation does not foreclose the fact that it may nevertheless be unenforcible if it is contrary to public policy. *Superior Oil Co.* v. *Western Slope Gas Co.*, 604 F.2d 1281, 1295 (10th Cir. 1979) (J. Barrett concurring).

**B. Federal Public Policy**

The court of appeals below relied on the Natural Gas Policy Act of 1978. 15 U.S.C. § 3301 *et seq.* ("NGPA"). The court seems to interpret the NGPA as an endorsement of any kind of indefinite price escalator clause no matter how conceived.

That is not the case. Federal policy cannot be said to support a ten-fold price increase over a four-year period. The purpose of the NGPA is one of price controls, not unlimited price increases. "[T]he statute's operation is limited to keeping sales prices from exceeding the ceiling." *Pennzoil Co.* v. *Federal Energy Regulatory Comm'n*, 645 F.2d 360, 374 (5th Cir. 1981). Under Section 105(b)(1) of the NGPA, the section applicable to Beaver Creek gas, the ceiling price may be escalated to the "new" gas price only if the contract contains a "sufficient escalation mechanism." *Id.* at 375. Whether Article 6(b) is a sufficient escalation mechanism is the question presented in this case. Such a question must be determined under state contract law. *Id.* at 382. The NGPA does not reflect a policy of

pushing all prices to the limits of the ceiling. The conference committee stated:

> "The conferees do not intend that the mere establishment of the ceiling prices under this act shall trigger indefinite price escalator clauses in existing intrastate contracts." H.R. Conf. Rep. No. 95-1752, 95th Cong. 2d Sess, p. 83, *reprinted in* [1978] 7 U.S. Code Cong. Admin. News 8983, 9000.

The court of appeals misinterprets federal policy when it concludes that the NGPA expresses an endorsement of Article 6(b). Rather, the effectiveness of indefinite price escalator clauses must be determined on a case by case basis, as particular facts may present themselves, and even identical language may lead to different results. *Pennzoil*, *supra* at 386. It is the facts of the case at bar which the court of appeals overlooked and did not consider. Facts which disclose an unconscionable clause contrary to the public interest.

## CONCLUSION

For the foregoing reasons, petitioners pray that a writ of certiorari be issued in this case.

Respectfully submitted,

WM. H. BROWN
BROWN, DREW, APOSTOLOS,
MASSEY & SULLIVAN
500 Petroleum Building
Casper, WY 82601
*Counsel of Record*
*for Petitioner*

WM. BRYCE ARENDT
P. O. Box 2800
Casper, WY 82601
*Associate Counsel*
*for Petitioner*

September 13, 1982

# APPENDIX A-1

**UNITED STATES COURT OF APPEALS**
**TENTH CIRCUIT**

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**Nos. 80-2273, 80-2274, 80-2275**
**CONSOLIDATED**

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KERR-MCGEE CORPORATION, a Delaware corporation,
*Plaintiff-Appellant,*

v.

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Defendant-Appellee,*

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NORTHERN UTILITIES, INC.,
*Plaintiff-Appellee,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation,
and PHILLIPS PETROLEUM COMPANY,
a Delaware corporation,
*Defendants-Appellants.*

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**Appeal From The United States District Court**
**For The District of Wyoming**
**(D.C. No. C78-006B and C78-081-B)**
**Consolidated**

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**SLIP OPINION**

FILED
United States Court of Appeals
Tenth Circuit
MAR. 23 1982
HOWARD K. PHILLIPS
Clerk

Peter J. Nickles of Covington & Burling, Washington, D.C. (Stephen H. Galebach of Covington & Burling and William T. Schwartz of Schwartz, Bon, McCrary & Walker, Casper, Wyoming, with him on the brief) for Kerr-McGee Corporation.

John S. Pfeiffer of Gorsuch, Kirgis, Campbell, Walker and Grover, Denver, Colorado (Ann E. DeVine of Gorsuch, Kirgis, Campbell, Walker and Grover, and Robert H. Landt of Amoco Production Company, Denver, Colorado, with him on the brief) for Amoco Production Company.

Houston G. Williams of Williams, Porter, Day & Neville, P.C., Casper, Wyoming (Thomas M. Blume and Frank A. Ackerman of Phillips Petroleum Company, Englewood, Colorado, with him on the brief), for Phillips Petroleum Company.

Wm. Bryce Arendt, of Northern Utilities, Inc., Casper, Wyoming and Wm. H. Brown of Brown, Drew, Apostolos, Massey & Sullivan, Casper, Wyoming (Claude W. Martin of Brown, Drew, Apostolos, Massey & Sullivan with them on the brief), for Northern Utilities, Inc.

B. J. Zimmerman and Patrick F. Timmons, Attorneys for The Superior Oil Company, Houston, Texas; Joseph C. Johnson and Thomas Burton, Attorneys for Conoco, Inc., Houston, Texas; and Robert C. Hawley and Gretchen A. VanderWerf of Dechert, Price & Rhoads, Denver, Colorado, on the brief for Amici Curiae for Conoco, Inc. and The Superior Oil Company.

David Crump, Professor of Law, University of Houston, Houston, Texas; Susan E. Waite of Legal Foundation of America; Keith Blinn, Professor of Law, University of Houston, Houston, Texas, on the brief for Amicus Curiae for Legal Foundation of America.

Steven F. Freudenthal, Attorney General of Wyoming, Cheyenne, Wyoming, on the brief for Amicus Curiae for the State of Wyoming.

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Before SETH, HOLLOWAY, and SEYMOUR, Circuit Judges.

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SEYMOUR, Circuit Judge.

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In this diversity action applying Wyoming law, Kerr-McGee Corporation, Amoco Production Company, and Phillips Petroleum Company (hereinafter collectively referred to as "producers") appeal a trial court decision striking down an indefinite price escalation clause in a contract for the sale of intrastate natural gas. The district court found the clause to be against public policy and unconsionable.[1] We reverse.

IN 1957, the predecessor of Amoco contracted to sell appellee Northern Utilities, Inc. intrastate natural gas from the Beaver Creek field in Wyoming. Amoco, Kerr-McGee, and Phillips owned working interests in the field and Amoco acted as unit operator. Northern is an intrastate public utility regulated by the Public Service Commission of Wyoming. Northern obtains approximately 85% of its total supply of gas from the Beaver Creek field and sells about 40% of the Beaver Creek gas to Amoco and its affiliates at facilities in Wyomong.

The original contract term between Northern and producers was for twenty years, beginning in 1958. It provided for price increases under a two-party favored nations clause that pegged the price of gas to the price Northern paid any other seller.[2]

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[1] The opinion below is published at 500 F. Supp. 624 (D. Wyo. 1980).

[2] The favored nations clause provided that:

> "If, at any time during the term of this agreement, Northern pays a producer of gas in the State of Wyoming a price per one thousand (1,000) cubic feet that is higher than the price being paid or otherwise payable under this contract, due consideration being given to the quality of the gas, bases of measurement and conditions of sale, Northern shall, commencing on the date of delivery of such gas at such higher price, and continuing so long as such price is in excess of the price otherwise payable under this contract, increase the price being paid or otherwise payable

The contract also granted Northern a preferential right to negotiate "for a suitable contract and price" for excess gas which might become available from Beaver Creek. App., vol. II, at 157. Northern executed contracts with Kerr-McGee and Phillips in 1958, which were identical in all relevant respects to its contract with Amoco.[3]

In 1970, Amoco notified Northern that excess gas from Beaver Creek was available for sale and invited Northern to negotiate for the purchase of the gas pursuant to its contract rights. The record indicates that Amoco, on behalf of the producers, wanted to sell the gas before the original contract was due to expire at the end of 1977. On the other hand, Northern wanted to delay production of the gas until 1978 and extend the term of the original contract.

After several months of negotiation, Amoco and Northern entered into a supplemental agreement which extended the contract through the end of 1990. The two-party favored nations clause was retained, and a new clause was added which is the subject of this litigation. The new clause, paragraph 6(b), is a third-party favored nations (or indefinite price escalator) clause. Under this provision, effective January 1, 1976, a rise in the contract price was to be triggered by the price received from the sale of *interstate* gas by *any* producer in the relevant area.[4] The supplemental contract was presented by Northern

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to Pan American hereunder to equal such higher price. It is the intention hereof that the price to be paid Pan American hereunder shall at all times be equal to the higher of the following: (a) the price payable under Article 5 of this contract, as such price may have been changed by Article 7, or (b) the highest price paid by Northern to a producer of gas in the State of Wyoming."

App., vol. II, at 149-50.

[3] The original contract was amended four times prior to 1970. These amendments are irrelevant to the instant appeal.

[4] The added paragraph provided that:

"(b) From and after January 1, 1976, when the price to be paid by Northern to Pan American pursuant to other provisions hereof is less than the sum of the price received for gas being sold

to the Wyoming Public Service Commission and approved for filing. Substantially similar contracts were executed in 1973 between Northern and Kerr-McGee, and Northern and Phillips, after Northern wrote to Kerr-McGee and Phillips urging them to execute the supplementary agreements.

In 1975, Amoco advised Northern that the price under the new contract would be set by paragraph 6(b) beginning January 1, 1976, because the price received by producers of interstate gas in the area would then exceed the rate established under other provisions of the contract. Northern requested and received approval from the Public Service Commission for a rate increase to cover the rise in the contract price. Amoco agreed to phase in the new prices until July 1, 1978, at which time the indefinite price escalator clause would become fully operative. Kerr-McGee did not agree to phase in the price and brought suit against Northern. Northern then sued Amoco and Phillips, and the actions were consolidated below.

After a bench trial, the judge held paragraph 6(b) void. He found that the operation of the clause would result in "exorbitant prices" beyond Northern's contemplation at the time the contract was executed. He emphasized that the issue involved a substantial public interest, and concluded that enforcement of paragraph 6(b) was contrary to public policy and unconsionable. He ordered that the remainder of the contract be enforced without the operation of paragraph 6(b).

On appeal the producers contend that the clause is not contrary to federal policy as it is articulated in the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (NGPA), or to

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in interstate commerce, by any producer within the State of Wyoming, except in the counties of Uinta and Lincoln, plus three cents per one thousand cubic feet (3¢/Mcf), then Northern shall increase the price to be paid Pan American hereunder to a price equal to the price being received by such producer plus three cents per Mcf."

App., vol. II, at 214.

Wyoming public policy. They also argue that the court's decision flies in the face of controlling Wyoming court pronouncements on both public policy and unconscionability. We agree and hold as a matter of law that paragraph 6(b) is not violative of public policy nor unconsionable under the facts of this case.

## I.

## PUBLIC POLICY

### A. *Federal Public Policy*

Prior to the enactment of the NGPA, contracts for the sale of intrastate gas were free from regulation. Thus, it was public policy to allow the competitive forces of the market place to set the price. The NGPA, however, imposed price controls on the intrastate gas market. *See* 15 U.S.C. 3315.[5] The Act specifical-

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[5] This section provides in pertinent part:

"§ 3315. Ceiling price for sales under existing intrastate contracts.

(a) Application.—The maximum lawful price computed under subsection (b) of this section shall apply to any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any successor to an existing contract, which was not committed or dedicated to interstate commerce on November 8, 1978.

(b) Maximum lawful price.—

(1) General rule.—Subject to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—

(A) the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date; or

(B) the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas).

(2) Contract price exceeding new gas ceiling price on November 9, 1978.—In the case of any natural gas described in subsection (a) of this section for which the contract price applicable on November 9, 1978, exceeds the maximum lawful price, per million Btu's, computed

ly permits the price under intrastate gas contracts to rise through the operation of indefinite price escalator clauses up to a maximum rate established by the Act. *See id.*; 18 C.F.R.

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for such date under section 3312 of this title (relating to new natural gas), the maximum lawful price under this section shall be the higher of—

(A) the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title; or

(B)(i) the contact[1] price on November 9, 1978, in the case of November 1978; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(3) Price increases resulting from indefinite price escalator clauses.—

(A) In general.—Effective January 1985, and each month thereafter, in the case of any first sale of natural gas, which is sold at a price established under any indefinite price escalator clause of any existing contract or successor to an existing contract and for which the contract price on December 31, 1984, is higher than $1.00 per million Btu's, the maximum lawful price under this section for any such natural gas delivered during any month shall be the higher of—

(i) the maximum lawful price, per million Btu's, computed under paragraph (2)(B); or (ii)(I) in the case of January 1985, the maximum lawful price, per million Btu's, computed under section 3312 of this title (relating to new natural gas) for such month; and

(II) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this clause for the immediately preceding month multiplied by the monthly equivalent of the sum of a factor equal to the annual inflation adjustment factor applicable for such month plus. 03.

(B) Definition of indefinite price escalator clause.—For purposes of this paragraph, the term "indefinite price escalator clause" includes any provision of any contract—

(i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference

§ 270.205 (b)(1) (1980)[6] *Pennzoil Co.* v. *FERC*, 645 F.2d 368, 360 (5th Cir. 1981).

The ceiling prices set by the NGPA clearly comport with the public interest as determined by Congress. *Pennzoil*, 645 F.2d at 379 n.37. The fact that prices under intrastate gas contracts containing indefinite price escalator clauses are high and will continue to rise does not mean that these contracts are against federal public policy. One of the primary purposes of the NGPA is to promote energy conservation. Congress believed that allowing producers to recover high prices for their gas helps implement this goal. "High energy prices provide one motivation to conserve energy. Because of these prices, an enormous range of energy conserving improvements are cost effective." S. Rep. No. 409, 95th Cong., 2d Sess. 36, *reprinted in* 1978 U.S. Code Cong. & Ad News 8800, 8806.

The only reason appearing in the district court's opinion to support its conclusion that the clause offends public policy is its finding of "exorbitant" cost to the consumer.[7] However, when

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to other prices for natural gas, for crude oil, or for refined petroleum products; or (ii) which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

[5] So in original. Probably should be "contract".

15 U.S.C. § 3315.

[6] 18 C.F.R. § 270.205(b)(1) (1981) provides in pertinent part:

"Any contractual provision for a change in price may operate according to the terms of such provision except that such provision is not operative to authorize a seller to charge and collect an amount in excess of the highest applicable NGPA rate."

[7] The judge indicated that he found the price particularly offensive because it was unrelated to the cost of production, and was higher than the producers themselves could have received for the gas in an interstate sale. The producers could not qualify for the "small producers" rate established for gas sales in interstate commerce, which was set at 130% of the ceiling rate established for large producers. *See*

Congress designed the NGPA, "[t]he balance Congress struck already took into account the conflicting interests of producers and consumers." *Pennzoil*, 645 F.2d at 379. Congress was well aware of the economic impact on consumers that would result from the operation of indefinite price escalator clauses. The decision to permit contract clauses to raise prices to a ceiling constitutes a clear legislative statement that the resulting high cost to the consumer is not contrary to federal energy policy.

### B. *Wyoming Public Policy*

We must look to the statutes and judicial decisions in Wyoming to determine that state's public policy with regard to the price escalation clause in this case. *See Taylor* v. *State*, 612 P.2d 851, 865 (Wyo. 1980) (Rooney, J., concurring).

Although Congress specifically legislated in the NGPA regarding pricing of intrastate gas, it nevertheless provided that states may restrict the operation of indefinite price escalator clauses if they choose to do so. *See* 15 U.S.C. § 3432(a).[8]

> "The conference agreement also cedes the Federal Government's authority to further limit the operation of indefinite price escalator clauses to State governments

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F.P.C. Opinion No. 742 (Aug. 28, 1975). However, paragraph 6(b), by pegging the contract cost to the price received by *any* producer selling interstate gas, allowed the producers to receive the "small producers" rate for interstate sales. Moreover, paragraph 6(b) contains no vintaging distinction between old and new gas. The ceiling rates for old gas sold in interstate commerce are lower than those for new gas. *See American Pub. Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1033 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978). Through the operation of 6(b), therefore, the producers here could receive the new gas rate for old gas. *See Amoco Prod. Co.* v. *Stauffer Chem. Co.*, 612 P.2d 463, 466 (Wyo. 1980).

[8] This sections provides:

"§ 3432. Effect on state laws.

"(a) Authority to prescribe lower maximum lawful prices.—Nothing in this chapter shall affect the authority of any State to

> wishing to do so. The Congress, by adoption of this section, recognizes the right of States to prescribe more stringent limitations on the operation of such clauses than those prescribed herein."

H.R. Conf. Rep. No. 1752, 95th Cong. 2d Sess. 83, *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 9000.

Some states have exercised their right to alter the public policy expressed in the NGPA by enacting greater restrictions on the use of indefinite price escalation clauses. *See, e.g.*, Kan. Stat. Ann. 1980 Supp. § 55-1401 *et seq.*; *Energy Reserves Group* v. *Kansas Power & Light Co.*, 630 P.2d 1142, 1150-53 (Kan. 1981). We believe it is significant that the Wyoming legislature has not enacted any restrictions on the operation of clauses such as the one at issue in this case.

Moreover, in *Amoco Production Co.* v. *Stauffer Chemical Co.*, 612 P.2d 463 (Who. 1980), the Wyoming Supreme Court approved the enforcement of a favored nations clause contained in an intrastate gas contract. Contrary to the assertion of the trial court in this action, the briefs of the parties in *Stauffer* reflect that the issue whether favored nations clauses are against public policy was argued to the Wyoming court in that case. Despite the public policy argument, the Wyoming Supreme Court ordered the clause to be given effect, stating that

> "[f]avored nations clauses are a common feature of gas purchase and sale contracts. The nature of the product and its questionable availability engenders reluctance on the part of producers to enter into long term contracts at the price prevailing at the time of contract. Yet purchasers require long term commitments to insure an adequate supply of gas. A two-party favored nations clause pro-

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establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter I of this chapter."

> vides an increase in price to match any higher price which the purchaser pays to any other seller. A third-party favored nations clause requires the purchase to match any higher price contracted to be paid by any other buyer in the same field or area. . . . Favored nations clauses are recognized by the courts. *Superior Oil Company* v. *Western Slope Gas Company*, 10th Cir. 1979, 604 F.2d 1281; *Holly Sugar Corporation* v. *Fritzler*, 42 Wyo. 446, 296 P. 206 (1931); *Texas Gas Transmission Corporation* v. *Shell Oil Company*, 363 U.S. 263, 80 S.Ct. 1122, 4 L.Ed.2d 1208 (1960).
>
> ". . . The principal objective of [a third party favored nations clause] is to escalate the agreed price to equal the *highest* price being paid for the commodity by any other purchaser."

*Stauffer*, 612 P.2d at 468 (footnotes omitted) (emphasis in original).

The opinion in *Stauffer* and the failure of the Wyoming legislature to alter the policy expressed by the NGPA clearly indicate that indefinite price escalation provisions are not against the public policy of the state of Wyoming. Accordingly, the trial court's conclusion that the clause at issue here offends public policy is without legal foundation.[6]

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[6] In so stating, we have considered the concurring opinion in *Superior Oil Co.* v. *Western Slope Gas Co.*, 604 F.2d 1281, 1291 (10th Cir. 1979). Contrary to the concurrence, we do not view the purpose of the remand by the majority in that case to include a determination whether favored nations clauses are void as contrary to public policy. The majority opinion rests, implicitly if not explicitly, on the proposition that such clauses do not violate public policy. The majority emphasized the amicus curiae brief filed with the trial court by the Public Utilities Commission of the State of Colorado (PUC) urging that favored nations clauses *not* be declared contrary to public policy, even though they permit the price of gas to rise above a price directly related to the cost of production. The majority agreed with the PUC that "[t]he actual value of a product is determined by what people will pay for it, not by what it costs to produce." *Id.* at n.15. The majority also noted that the NGPA "provides for a free market between producers and purchasers in the long run." *Id.* at n.16.

## II.

## UNCONSIONABILITY

The trial court also held paragraph 6(b) to be unconsionable, citing section 34-21-219 of the Wyoming statutes.[10] The court's conclusion of unconsionability rests on the dramatic rise in the cost of gas resulting from the effect of the price escalator clause. The producers contend on appeal that the court used an incorrect legal standard in making its determination, and that the record contains no evidence to support its conclusion.

The leading Wyoming case on unconsionability, *In re Estate of Frederick*, 599 P.2d 550 (Wyo. 1979), was inexplicably not cited or considered by the trial judge in his opinion. In *Frederick*, the Wyoming Supreme Court pointed out its "reluctance to redraw contracts for the parties," *id.* at 556, and stated that "[i]n the absence of overreaching, the court should not aid those who have made an unwise bargain in the formation of the contract." *Id.* Under Wyoming law,

> *"[u]nconsionability is tested as of the time the agreement is made and not in accordance with hindsight. . . .* It is considered as a form of fraud recognized in equity, but such fraud should be 'apparent from the intrinsic nature and subject of the bargain itself; such as no man in his senses and not under delusion would make on the one

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[10] That section provides:

> "(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
>
> "(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."

Wyo. Stat. § 34-21-219.

> hand, and as no honest and fair man would accept on the other; which are unequitable and unconscientious bargains.' . . . The Supreme Court of Oklahoma has defined the test of unconscionability as whether, 'under the circumstances existing at the time of making of the contract, and in light of the general commercial background and commercial needs of a particular case, clauses are so one-sided as to oppress or unfairly surprise one of the parties.' "

*Id.* (citations omitted) (emphasis added).

The considerations set out in *Frederick* relevant to a determination of unconscionability are whether: 1) the protesting party was deprived of meaningful choice as to whether to enter into the contract; 2) the party was compelled to accept the terms; 3) there was opportunity for meaningful negotiation; and 4) there was gross inequality of bargianing power. *Id.* at 556. The burden is on the complaining party to "demonstrate that the clause in question was unconscionable at the time the contract was made." *W. L. May Co.* v. *Philco-Ford Corp.*, 543 P.2d 283, 286 (Ore. 1975).

The commercial circumstances surrounding the execution of the supplemental agreement are evidenced by the record on appeal in this case. Mr. Magagna, the representative from Northern who negotiated the contracts with Amoco, testified that Northern could not use the additional gas at the time it was offered for sale by Amoco and sought instead to obtain a contract extension to use the gas "down the line." App., vol. I, at 62. Amoco wanted to recover the price of the gas immediately. Magagna further testified that he and the people from Amoco negotiated back and forth for several months, *id.* at 63, and that one of the benefits to Northern from the new contract was the assurance of a twenty-year supply of gas for its customers. *Id.* at 78. We note, as did the Court in *Stauffer*, 612 P.2d at 468, that favored nations clauses constitute the quid pro quo that induces producers of natural gas to enter into long-term contracts. In its statement to the Public Service Commission accompanying its submission of the contract for approval, Northern referred to the difficulty in obtaining long-

term commitments, and the advantages it believed it would receive from the amended contract.[11] Moreover, in a series of letters over a two-year period, Northern urged Kerr-McGee

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[11] That statement provided in relevant part:

"In 1957, according to our best estimates, Northern Utilities Company and Northern Gas Company had adequate gas supplies for the ensuing twenty (20) year period. Since 1957, many changes have occurred, some of the principal ones being:

> *First*—Thirteen (13) years have elapsed and a substantial part of the gas supplies on hand in 1957 have been depleted and are continuing to be depleted each year . . . .
>
> "*Second*—There has been a substantial increase in the demand of both companies for gas service . . . .
>
> "*Third*—The national demand for natural gas has resulted in various large interstate pipelines becoming competitive for natural gas supplies available in Wyoming. These interstate companies are offering various types of bonuses in order to obtain calls on any gas which may be produced, such as participating in drilling costs, making advance payments for future gas deliveries, making interest free loans, etc. These interstate companies are agreeing to take or pay for substantial volumes of gas in the initial years in order to provide a fast well payout. These interstate companies are also agreeing to accept delivery of gas at wellhead and to install and operate, at Buyer's expense, to the extent required, all gathering, dehydrating and compression facilities. All natural gas producers are anxious to deliver substantial volumes of gas as soon as wells are completed because of the high "present worth" of money. It is very difficult for an intra-state gas distribution company, with a relatively limited market and highpeak demands and a low load factor, to compete against these interstate companies and negotiate any long term gas supply contracts.

* * * *

"Northern Utilities, Inc., received a letter dated April 7, 1970 from Pan American Petroleum Corporation [predecessor of Amoco] relative to gas being produced at Beaver Creek Field, Fremont County, Wyoming, reading as follows:

> 'As provided in Article 8.(d) of the contract referenced above, Pan American hereby serves notice that it has more than 60 BCF

and Phillips to execute supplementary contracts with provisions identical to Northern's contract with Amoco.

The trial court found that the sharp price increases were not contemplated by Northern at the time of contracting. This finding cannot support a determination of unconsionability under Wyoming law. "The risk of the effects of inflation . . . however, is inherent in any contract which includes an option to purchase in the future. Mere increase in the value . . . does not invalidate a contract . . . ." *Frederick*, 599 P.2d at 556.

In construing the Utah provision of the Uniform Commercial Code, which is identical to Wyo. Stat. § 34-21-219 cited by the trial court here, this court reiterated that "an increase in price has nothing to do with unconscionability." *Bernina Distributors, Inc.* v. *Bernina Sewing Machines*, 646 F.2d 434, 440 (10th Cir. 1981). In *Bernina*, we pointed out that

> "the principle of that provision is one of 'prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power.' In order to avail oneself of the section, proof must show the contract is 'so one-sided as to be unconscionable

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of gas in the reservoirs identified in the contract, which exceed the maximum quantity specified in Exhibit "B".

'Pan American desires to sell the 60 BCF coextensively with the gas sales already contemplated.

'Accordingly, we invite you to exercise your right to negotiate for the purchase of the additional gas quantity.'

"As set forth in the letter Pan American Petroleum Corporation desired to market this additional gas during the next eight years. In order to provide future gas service for the customers of Northern Utilities, Inc. and of Northern Gas Company, we desired to have the production of this gas delayed until after 1978. After six (6) months of negotiations we have entered into the following agreements which we are submitting for filing at this time . . . ."

App., vol. II, at 125-28.

> under the circumstances existing *at the time of the making* of the contract.' "

*Id.* (quoting Uniform Commercial Code § 2-302, comment 1) (emphasis in original).

In this case, experienced negotiators for both parties entered into an agreement after several months of give-and-take. Northern was not compelled to enter into the contract and clearly believed the contract terms were to its advantage at the time of execution and for several years thereafter. Based on our review of the record, we conclude as a matter of law that Northern failed to demonstrate unconscionability under Wyoming law.

In upholding this contract, we are mindful that "[c]ourts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved." *Virginian Railway* v. *System Federation No. 40*, 300 U.S. 515, 552 (1936). The courts have power to implement the public interest. The prerequisite to the exercise of this equitable power, however, is a determination of where the public interest lies. In this case, the rise in gas prices borne by the consumer as the result of this contract, which the trial court found so disturbing, is not contrary to either federal or Wyoming public policy, nor is it the result of unconscionability.

The decision of the trial court is reversed, and the case is remanded for further proceedings consistent with this opinion.

# APPENDIX A-2

**Order Denying Rehearing Of Opinion Of Court Of Appeals Below**

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**Nos. 80-2273, 80-2274, 80-2275 (consolidated)**

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KERR-MCGEE CORPORATION,
*Plaintiff-Appellant,*

v.

NORTHERN UTILITIES, INC., A Wyoming corporation,
*Defendant-Appellee,*

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NORTHERN UTILITIES, INC.,
*Plaintiff-Appellee,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation, and PHILLIPS PETROLEUM COMPANY, a Delaware corporation,
*Defendants-Appellants.*

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**MAY TERM - JUNE 14, 1982**

**Before Honorable Oliver Seth, Honorable William J. Holloway, Jr., Honorable Robert H. McWilliams, Honorable James E. Barrett, Honorable William E. Doyle, Honorable Monroe G. McKay, Honorable James K. Logan, Honorable Stephanie K. Seymour, Circuit Judges**

This matter comes on for consideration of Appellee's, Northern Utilities, Inc., petition for rehearing and suggestion for rehearing in banc in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied by the panel to whom the case was argued and submitted.

The petition for rehearing having been denied by the panel to whom the case was argued and submitted, and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing in banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing in banc is denied.

HOWARD K. PHILLIPS, Clerk

/s/ By ROBERT L. HOECKER

Robert L. Hoecker
Chief Deputy Clerk

# APPENDIX A-3

**Order Staying Mandate Pending Application For Certiorari**

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**Nos. 80-2273, 80-2274 and 80-2275**
**(consolidated)**

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KERR-MCGEE CORPORATION,
*Plaintiff-Appellant,*

v.

NORTHERN UTILITIES, INC., A Wyoming corporation,
*Defendant-Appellee,*

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NORTHERN UTILITIES, INC.,
*Plaintiff-Appellee,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation,
and PHILLIPS PETROLEUM COMPANY,
a Delaware corporation,
*Defendants-Appellants.*

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LEGAL FOUNDATION OF AMERICA,
THE STATE OF WYOMING and CONOCO, INC.,
SUPERIOR OIL COMPANY,
*Amici Curiae.*

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**JULY TERM - August 5, 1982**

**Before Honorable Oliver Seth, Honorable William J. Holloway, Jr., and Honorable Stephanie K. Seymour, Circuit Judges**

This matter comes on for consideration of appellee's motion for stay of mandate in the captioned causes pending timely application to the Supreme Court for certiorari.

Upon consideration whereof, the motion for stay of mandate is granted. The mandate shall be stayed until September 4, 1982, pending certiorari, and that if on or before that date there is filed with the Clerk of the Court of Appeals a notice from the Clerk of the Supreme Court of the United States that appellee has timely filed a petition for writ of certiorari in the Supreme Court, the stay shall continue until final disposition by the Supreme Court.

/s/ HOWARD K. PHILLIPS
Howard K. Phillips
Clerk

# APPENDIX A-4

## Opinion And Judgment Of District Court Below

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF WYOMING

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**No. C78-006B**
**consolidated with**
**No. C78-081B**

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KERR-MCGEE CORPORATION, a Delaware corporation,
*Plaintiff,*

v.

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Defendant.*

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NORTHERN UTILITIES, INC., a Wyoming corporation,
*Plaintiff,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation,
and PHILLIPS PETROLEUM COMPANY,
a Delaware corporation,
*Defendants.*

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FILED
DISTRICT OF WYOMING
OCT. 23, 1980

### FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled matter having been tried to the Court, on June 25, 26, and 27, 1980, Kerr-McGee Corporation appearing by and through William T. Schwartz, Esq., B. J. Zimmerman, Esq., and Peter J. Nickles, Esq., Northern Utilities, Inc.

appearing by and through William H. Brown, Jr., Esq., Claude W. Martin, Esq., Edwin V. Magagna, Esq., and William Bryce Arendt, Esq., Amoco Production Company appearing by and through John S. Pfeiffer, Esq., and R. H. Landt, Esq., Phillips Petroleum Company appearing by and through Houston G. Williams, Esq., Thomas M. Blume, Esq., and Dale A. Mayer, Esq., and the State of Wyoming, appearing amicus curiae, by and through Steven R. Shanahan, Assistant Attorney General for the State of Wyoming, and the Court having heard the testimony submitted for and on behalf of the parties, and having reviewed the pleadings, the Agreed Statement of Facts, the evidence, the exhibits, and briefs filed for and on behalf of the parties, and being fully advised in the premises, makes the following Findings of Fact and Conclusions of Law.

## FINDINGS OF FACT

1. The jurisdiction of this Court is founded upon the diversity of citizenship of the parties and the requisite amount in controversy. 28 U.S.C. § 1332.

2. Northern Utilities, Inc. ("Northern"), is a corporation incorporated under the laws of the State of Wyoming, with its principal place of business in Wyoming. Northern Utilities, Inc. is the successor in interest of Northern Utilities Company.

3. Northern is an intrastate public utility, certificated by the Public Service Commission of the State of Wyoming. Northern's rates, its service, and its earnings are regulated by the Public Service Commission of Wyoming. As a public utility, Northern is permitted to earn a fair, just and reasonable rate of return on its capital investment.

4. Kerr-McGee Corporation ("Kerr-McGee"), formerly Kerr-McGee Oil Industries, Inc., is a corporation incorporated under the laws of the State of Delaware, whose principal place of business is Oklahoma City, Oklahoma.

5. Amoco Production Company ("Amoco"), is a corporation incorporated under the laws of the State of Delaware, whose principal place of business is Chicago, Illinois, and who is duly

authorized to transact business in the State of Wyoming. Amoco is the successor in interest of Pan American Petroleum Corporation, which was the successor in interest of Stanolind Oil and Gas Company.

6. Phillips Petroleum Company ("Phillips"), is a corporation incorporated under the laws of the State of Delaware, whose principal place of business is Bartlesville, Oklahoma, and who is duly authorized to transact business in the State of Wyoming.

7. This case involves the interpretation of intrastate Gas Sales Contracts between (1) Amoco and Northern Utilities, dated November 20, 1957, as amended by a Supplemental Agreement, dated October 1, 1970; (2) Kerr-McGee and Northern Utilities, dated October 14, 1958, as amended by a Supplemental Agreement, dated February 23, 1973; and (3) Phillips and Northern Utilities, dated May 20, 1958, as amended by a Supplemental Agreement dated May 4, 1973.

8. Amoco, Kerr-McGee, and Phillips each own working interests in oil and gas leases in the Beaver Creek unit, Fremont County, Wyoming. The ownership interests of the parties in the various formations in the Beaver Creek Field are as follows:

| | | |
|---|---|---|
| Frontier-Dakota Formation | | |
| Amoco | — | 86.35979% |
| Kerr-McGee | — | 5.93651% |
| Phillips | — | 7.70370% |
| Madison Formation | — | Amoco 100% |
| Phosphoria Formation | — | Amoco 100% |
| Tensleep Formation | — | Amoco 100% |
| Second Cody Formation | — | Amoco 100% |
| First Cody Formation | — | Amoco 100% |

9. All of the natural gas involved in this case is produced from wells producing from the Frontier-Dakota participating

area, and from wells producing from the Phosphoria formation. Such producing wells were commenced (spudded) on various dates between September 1, 1937 and October 31, 1969.

10. Northern's principal service areas are Lander, Riverton, Casper and intermediate communities in Wyoming. Northern sells part of this gas to Northern Gas Company, an intrastate public gas utility which serves Rawlins, Laramie, and intermediate communities. All of the Beaver Creek gas is sold to Northern pursuant to contracts with Amoco, Kerr-McGee and Phillips.

11. Amoco is the unit operator of the Beaver Creek Unit Area (Beaver Creek Field) under a Cooperative Development Contract and Unit Plan dated March 29, 1932, and amendments thereto. As such operator Amoco collects and receives payments from Northern for all of the gas produced and sold from the Beaver Creek Field and distributes to Phillips and Kerr-McGee their respective shares thereof. Amoco also pays all severance taxes, production taxes, ad valorem taxes and all royalties for its account and for the account of Phillips and Kerr-McGee. Northern obtains approximately 85% of its total supply of gas from the Beaver Creek Field under the above-mentioned Gas Sales Contracts. Northern sells to the Standard Refinery in Casper (an affiliate of Amoco) and to Amoco at Salt Creek and Winkleman Dome gas volumes approximating 40% of the total annual volume purchased from Beaver Creek. Northern receives for gas delivered to said points a price per Mcf equal to the price it pays for Beaver Creek gas at the Beaver Creek Field plus a fee of 5 cents per Mcf for gas delivered to the Casper refinery, 6 cents per Mcf for gas delivered to Salt Creek and 9 cents per Mcf for gas delivered to Winkleman Dome. The obligation of Northern to sell and deliver such quantities extends to the expiration of the Supplement, December 31, 1990.

12. Northern and Amoco entered into a twenty-year Gas Sales Contract dated November 20, 1957 (herein referred to as the "1957 Amoco Contract"), in which Amoco agreed to sell and Northern agreed to buy all of Amoco's Beaver Creek gas, up to

maximum quantities specified therein. Northern and Kerr-McGee entered into a Gas Sales Contract dated October 14, 1958, (the "1958 Kerr-McGee Contract"), in which Kerr-McGee agreed to sell and Northern agreed to buy all of Kerr-McGee's gas, up to the maximum quantities specified therein, allocated to or owned by Kerr-McGee from certain lands and formations in the Beaver Creek Field. Northern and Phillips entered into a Gas Sales Contract dated May 20, 1958 (the "1958 Phillips Contract") wherein Phillips agreed to sell and Northern agreed to buy all of Phillips' gas, up to the maximum quantities specified therein, allocated to or owned by Phillips from certain lands and formations in the Beaver Creek Field, at the same price and in accordance with the other relevant terms of the 1957 Amoco Contract. All of the terms of the 1958 Kerr-McGee Contract and the 1958 Phillips Contract relevant to this lawsuit are identical to those in the 1957 Amoco Contract. Both Phillips and Kerr-McGee ratified the 1957 Amoco Contract without negotiations with Northern.

13. The 1957 Amoco Contract was amended four times prior to 1970, but these amendments did not make changes in the contract price. The first and third amendments incorporated into the contract deliveries of Sherwood Unit Gas produced in Natrona and Converse Counties, Wyoming. These amendments are no longer of concern, the Sherwood Unit Gas having been exhausted. The second amendment changed the point of delivery to the Beaver Creek Gas. The fourth amendment concerned the sale by Amoco to Northern of its wholly-owned gas from the Phosphoria formation in the Beaver Creek Field.

14. In April, 1970, pursuant to Amoco's letter, Northern and Amoco entered into negotiations which were carried on in Amoco's Denver office and which culminated in the Supplemental Agreement dated October 1, 1970 amending the 1957 Amoco Contract (herein referred to as the "Amoco Supplement" or the "Supplement") and a number of related or collateral agreements referred to elsewhere herein. On February 23, 1973, Northern and Kerr-McGee entered into a Sup-

plemental Agreement (the "Kerr-McGee Supplement") wherein all relevant terms were identical with those in the supplement negotiated by Amoco and Northern. On May 4, 1973, Phillips and Northern entered into a Supplemental Agreement (the "Phillips Supplement") amending said 1958 Phillips Contract wherein all relevant terms were identical with those in the Supplement negotiated by Amoco and Northern.

15. Paragraph 4 in each of said supplements provides as follows:

> "4. The paragraph comprising present Article 6, Favored Nations Clause, is designated (a), and the following new paragraph (b) is added to said Article 6:
>
> > "(b) From and after January 1, 1976, when the price to be paid by Northern to Pan American pursuant to the other provisions hereof is less than the sum of the price received for gas being sold in interstate commerce, by any producer within the State of Wyoming, except in the counties of Uinta and Lincoln, plus three cents per one thousand cubic feet (3¢Mcf), then Northern shall increase the price to be paid Pan American hereunder to a price equal to the price being received by such producer plus three cents per Mcf." (Said new paragraph (b) will be referred to herein as "Article 6(b)").

Clause 6(b) is not a standard clause of common use in the industry, but is a unique provision. Arles H. Barrett, of Amoco, testified that he knows of no other contract containing this clause.

16. All relevant terms and provisions in the separate contracts referred in this case between Phillips and Kerr-McGee with Northern are identical with the contracts between Amoco and Northern from which they were copied or adopted by reference. For brevity references made in these findings to the Supplement will also apply to the Phillips Supplement and the Kerr-McGee Supplement unless otherwise noted.

17. The 1957 Amoco contract is a 41 page document plus an Exhibit A, setting forth the acreage dedicated to the contract, an Exhibit B setting forth the quantities of gas to be delivered,

received and paid for, and an Exhibit C, setting forth a map of the pipeline to be built by Northern from Beaver Creek to Casper. The quantity which Northern is obligated to take or pay for in any year ("take or pay" obligation) is set forth in Exhibit B and is conditioned upon the producers' ability to deliver the specified maximum quantities ("peak deliverability").

18. Article 5 of the 1957 Amoco contract sets forth a base price per Mcf of the gas to be delivered in each of the 20 years during the contract term. The price for year 1959 is 10.17 cents Mcf and each succeeding year's price is incrementally higher; the base price for year 1978 is 20.18 cents.

19. Article 7 of the 1957 Amoco Contract is entitled "Inflation-Deflation Adjustment." It provides for adjustments each year of the Article 5 base price for inflation or deflation determined by references to the Wholesale Price Index. Article 16 of the 1957 Amoco Contract provides by a reference to Article 10 of Chapter 32, WCS 1945, that ad valorem taxes will be borne by the parties against whom the tax is levied and other taxes therein specified assessed against the producers would be reimbursed by Northern to the extent of three-fourths thereof. The Supplement makes no change in Article 16 with respect to ad valorem taxes but increased from seventy-five percent to one hundred percent the amount of reimbursement for other taxes to be paid by Northern.

20. The Supplement amends the 1957 and 1958 contracts in the following respects:

(1) extends the term 12 years and two months to December 31, 1990;

(2) increases the base prices set forth in Article 5 for the period of the next ended term (the base prices for the extended term are set forth for each year providing for a base price of 21.81¢ for year 1979, incrementally higher prices for each year thereafter with a base price of 29.84¢ for year 1990) all subject to adjustment of inflation or deflation;

(3) increases the annual take or pay obligation of Northern relative to the peak deliverability obligation of producers from a ratio of 59% to a ratio of 92.7% beginning in 1970 through 1990 by incorporation of a revised Exhibit B;

(4) redesignates Article 6 of the 1957 contract as Article 6(a) and adds a new Article 6(b) which new article is at the center of the principal controversy herein;

(5) increases the minimum daily quantity that Northern is obligated to receive from 11 thousand Mcf plus deliveries at Salt Creek, to 15 thousand Mcf plus deliveries at Salt Creek and Winkleman Dome;

(6) decreases the delivery pressure obligation of Amoco from 600 psia to 580 psia;

(7) provides that if Amoco is unable to deliver Phosphoria formation gas, Northern nevertheless shall be obligated to purchase an additional quantity from other Beaver Creek formations as will make up the deficiency of Phosphoria formation gas; and

(8) increases the obligation of Northern to reimburse severance and conservation taxes from 75% to 100% but does not change Article 16 as to ad valorem taxes; and

(9) continues the provisions of the 1957 contract authorizing the producers to suspend deliveries and terminate the contracts in the event of a default by Northern.

21. The Supplement was negotiated by Amoco on the premise that there were a number of advantages to be derived from selling the excess gas to Northern. The memorandum from K. W. Beaver to Mr. Hegglund (exhibit I-7) shows that the price from Northern would be better than in an interstate sale, the sale could be started as soon as an agreement was made with Northern, whereas an interstate sale would have required about two years of FPC negotiations. Amoco calculated that Amoco could sell over $15,000,000 of additional gas to Northern during the next eleven years if the reservoir is capable of producing the rates necessary to do this. That number would convert to 25¢ per Mcf for sixty billion cubic feet. Mr.

Beaver therein noted "We need to look at the above deal with Northern in comparison to another deal whereby we would sell the sixty billion cubic feet to a second party and have a two-year delay in marketing because of the FPC requirements." In addition, he notes Amoco needed to look at the benefits that would accrue to Amoco through reduced investment if the sale were to be made to Northern as outlined and the benefit to Amoco of reduced maximum peak requirements.

22. In an early Amoco draft of the proposed Supplement (Exhibit I-8), Mr. Barrett made a note reading "Need an excess of FPC price clause," and Exhibit I-9 is a copy from another contract of a clause which he marked "guide addition." That clause specifically referred to "a just and reasonable rate for the area . . . as prescribed by Order of the Federal Power Commission. . ."

23. Mr. Barrett and Mr. Magagna discussed the addition of a clause which would permit the seller to increase the price to the just and reasonable rate for the area to be established for the Rocky Mountains by the Federal Power Commission. In Amoco's first draft of the Supplement (Exhibit I-8) no clause was contained other than clause 6(a) to provide for an indefinite future price. A clause (Exhibit I-9) was suggested by Amoco to its scrivener to add a provision for escalation equal to the FPC "just and reasonable rate for the area." This clause was not used but in a subsequent draft of the Supplement Amoco inserted in paragraph 4 (Exhibit 10) the essence of clause 6(b). Mr. Barrett testified that this clause was written by Amoco's legal counsel at his direction and that it was his intention that the clause would permit Amoco to collect the highest price received by any producer selling any gas in interstate commerce in the prescribed area without regard to any other conditions.

24. Edwin V. Magagna testified that his understanding of the purpose of clause 6(b) was to provide an alternate price to the specific contract terms in the event that the price which Amoco could have received if it sold the gas to an interstate buyer instead of to Northern in 1970 would be higher than the

specific prices set forth in Article 5 adjusted by Article 7 of the 1957 Gas Sales Contract.

25. The concept of FPC area price controls (as distinguished from well head price controls) was first advanced in the Permian Basin Area Rate Proceedings, 34 FPC 159 (1965), and the concept was approved by the Supreme Court by its decision *In re Permian Basin Area Rate* Cases, 390 U.S. 747 (1968).

26. In 1970 and 1973 the producers were aware that the FPC was proposing new rules to regulate nationwide new sales of natural gas in interstate commerce, specifically including Wyoming. Notices of such proposed rule making and request for comments from all interested parties on rate of return and other factors and of the times and places of public hearings, dated June 17, 1970 and July 17, 1970, were published in the Federal Register. (Exhbits J and K). At that time the FPC had not yet established the boundaries for the area which would include the State of Wyoming. The parties contemplated that the State of Wyoming, with the exception of Lincoln and Uinta Counties, would be one area for FPC area prices.

27. The FPC began establishing rates for the Rocky Mountain Area by FPC Order No. 435, 46 FPC 68, which was issued July 15, 1971. This order identified six sub-areas which the FPC had determined to exist within the Rocky Mountain Area. These sub-areas included the Uinta-Green River Basin Area which including the Wyoming counties of Lincoln, Uinta, Carbon, Sweetwater and Sublette, as well as several other counties in the States of Utah and Colorado. The sub-area defined as Montana-Wyoming Area included the remaining counties in Wyoming.

28. FPC Opinion No. 658, issued April 11, 1973, modified the definition of Uinta-Green River Basin sub-area to include the following Wyoming counties: Albany, Carbon, Sweetwater, Sublette, Lincoln and Uinta, and further provided that the Montana-Wyoming sub-area would include the remaining Wyoming counties.

29. On December 4, 1974, the Federal Power Commission issued its Opinion 699-H, effective June 21, 1974. Therein the Commission established a maximum base rate of $0.50 per Mcf for gas sold in interstate commerce which was produced from wells spudded on or after January 1, 1973. None of the gas that is the subject matter of this action would qualify for this FPC price if it had been sold in interstate commerce. On August 28, 1975, the Federal Power Commission issued FPC Opinion No. 742, effective August 28, 1975. Under this opinion the FPC established the maximum rate for sales made by small producers after August 28, 1975 at 130% of the applicable base ceiling rate established for large producers. The stated purpose of FPC Opinion No. 742 was to recognize the additional costs experienced by small producers and to encourage the drilling by them of exploratory wells to foster the development of new supplies of natural gas by small producers. None of the producers in this action could have qualified as small producers for purposes of FPC Opinion No. 742 had they been selling gas in interstate commerce.

30. On July 27, 1976, the Federal Power Commission issued FPC Opinion No. 770, effective as of July 27, 1976. On November 5, 1976, the FPC amended Opinion No. 770 issuing FPC Opinion No. 770-A, which opinion was retroactively effective as of July 27, 1976. In FPC Opinion No. 770-A the FPC continued the major vintage distinction between old and new gas and provided further vintaging distinctions within the new gas category. These vintaging distinctions were as follows:

A. Gas from wells commenced prior to January 1, 1973, was subject to a base price ceiling of 29½ cents per Mcf.

B. Gas which was not previously dedicated to interstate commerce from wells commenced prior to January 1, 1973, was subject to a base price ceiling of 52 cents per Mcf.

C. Gas from wells commenced after January 1, 1973, and before January 1, 1975, was subject to a base price ceiling of 93 cents per Mcf.

D. Gas from wells commenced on or after January 1, 1975, was subject to a base price ceiling of $1.42 subject to a one cent per quarter escalation.

31. On November 9, 1978, the President of the United States signed the Natural Gas Policy Act of 1978 (NGPA), which then became effective December 1, 1978, and which retained vintaging distinctions. The NGPA is designed to decontrol prices for certain categories of natural gas and are directed primarily at new natural gas wells. The Act does not generally deregulate prices of gas from existing wells.

32. Under Section 105 of the NGPA, for any intrastate contract existing on the date of enactment any gas sold after the enactment date is subject to a maximum lawful price equal to the lower of the contract price or the maximum lawful price as calculated for new natural gas under Section 102 of the NGPA. New natural gas will qualify for price deregulation on January 1, 1985. New natural gas prices increase monthly by reason of an inflation adjustment factor plus a real growth factor.

32. Early in December 1975 Amoco demanded payment from Northern of a price which would include the FPC 130 percent allowance to small producers. (Exhibit I-23). Amoco noted in Exhibit I-23 that if contract vintage were considered the price would be 24¢ or 35¢ per Mcf. Without the small producer allowance and without regard to contract vintage (the date of the Contract to sell natural gas) the FPC price would be 53¢ per Mcf, and the small producer price would be 53¢ times 1.3

34. After FPC Opinion No. 770 was issued and became effective, representatives of Northern and Amoco met in Cheyenne, Wyoming on August 2, 1976 to discuss Amoco's plan to phase in the price increases to which Amoco claimed it was entitled under the terms of the supplemental agreements. Instead of demanding that Northern start immediately paying the amounts to which Amoco claimed entitlement under clause 6(b), Amoco agreed to phase in the price increase over a period

of time. Thereafter Amoco sent a letter dated August 5, 1976, to Northern (Exhibit D). Amoco agreed to give Northern one working day's notice of the new price it would propose to collect and the date of collecting such new price in order that Northern could file an application with the Wyoming Public Service Commission for an increase in tariffs reflecting such increase. Also Amoco therein agreed to waive any claim for payment of any increased price under the contract prior to the date stated in the notice.

35. After FPC Opinion No. 770-A was issued and became effective, Amoco sent a letter to Northern dated December 8, 1976 (Exhibit E) which stated that Amoco elected pursuant to Article 6(b) of the contract to commence collecting prices less than the price resulting from Opinion 770 effective as of January 1, 1977. For gas delivered during the period commencing on January 1, 1977, and ending on June 30, 1977 Amoco was electing to assert collection of a price of $1.06 per Mcf and for gas delivered during the period commencing July 1, 1977 and ending June 30, 1978 Amoco was electing to assert collection of a price of $1.43 per Mcf. Commencing July 1, 1978 Amoco gave notice that it intended to collect the full price resulting from Opinion 770.

36. From the inception of the contract relationship between Northern and the three producers no payments were made directly to Phillips or Kerr-McGee by Northern. Amoco was authorized by Kerr-McGee and Phillips to receive and make settlement for payments of their share of Beaver Creek gas, and Amoco in turn distributed to Phillips and Kerr-McGee their respective shares thereof. (Exhibit A-1).

37. After FPC Order No. 435 became effective and as of January 1, 1972, Amoco calculated that the maximum price it could collect for Beaver Creek Field gas was 19.162¢ per Mcf, including adjustment for inflation and tax reimbursement plus any increase in taxes above the calculated reimbursement. (Exhibit I-22).

38. Northern was faced with the alternative of making payment of the rates requested by or for the producers and obtaining a new tariff allowance from the Wyoming Public Service Commission to cover the increase or suffering a possible termination of the contract and losing its long term supply of natural gas under the default provisions of the contracts. When given this choice, Northern elected to pay the demanded amounts until a settlement could be made or the question of price could be determined. Northern's election to pay the price demanded was based upon its inability to be certain whether or not FPC Opinion No. 770 and FPC Opinion No. 770-A activated said price escalation clause and its inability to withstand termination for non-payment. Additionally if Northern did not obtain an increased tariff from the Public Service Commission, it could not collect the increased price retroactively from its customers, although it could refund any excess payments if the higher prices were reduced by settlement or adjudication.

39. The prices demanded by and paid to the producers by Northern have had an inequitable result, causing rate payers buying gas at retail to be charged exorbitant prices for the natural gas involved in this case grossly beyond any reasonable expectation of Northern as one of the contracting parties.

40. At the times the parties executed the Supplemental Agreement FPC price controls were directed to holding down the price of natural gas on an area pricing basis, determined on the producers' costs plus a reasonable return on investment.

41. At the times the parties executed the Supplemental Agreement, Northern did not contemplate nor was it suggested by any other party that FPC pricing practices then existing and contemplated would materially or substantially change during the term of said contracts.

42. Each of the producers has claimed from the effective date for clause 6(b) that it was entitled thereby to receive the highest price for any gas sold in interstate commerce regardless of the kind of gas, the special circumstances of the sale, extraordinary values attributable thereto, not common or similar to the gas in question or any other circumstances.

43. It was beyond the contemplation of Northern at the time it executed the Supplemental Agreement that FPC Opinion No. 699-H, FPC Opinion No. 742, FPC Opinion No. 770, FPC Opinion No. 770-A and the Natural Gas Policy Act of 1978 would be claimed to activate Article 6(b) so that Northern would be required to pay rates for Beaver Creek gas which would be greatly different or exorbitant in comparison to rates incorporated in the contract between the parties. (Substituted Exhibit 11 and Exhibit G). It is doubtful that the producers contemplated such sharp increases for small producers and new natural gas but their intention was to claim the highest price which might be received by any prodcuers in the Wyoming area for any gas sold in interstate commerce. (Testimony of Arles J. Barrett, and Exhibits I-11, I-13, I-21, as well as the demands for the receipt of payment including small producers' allowance and other escalations reflected on defendants' Exhibit 11).

44. The effect of the supplemental contracts with clause 6(b) contained therein was to provide by an indefinite price escalator clause the benefit of extraordinary price increases authorized by the Federal Power Commission for producers and gas supplies meeting the conditions precedent to receiving such a high price while such conditions could not be met by the producers herein nor by Beaver Creek gas supplies. The effect of clause 6(b) was to obtain the unlimited high price allowed for gas sold in interstate commerce without regard to the interest of Northern and without regard to the interest of the public retail consumers who would be required to pay retail rates sufficient to cover such escalated prices.

45. Without clause 6(b) in the Supplement each producer still has the right to receive increased contract price adjustments for inflation and the benefits of the favored nations clause 6(a) if Northern should pay a higher price to a third party for gas. There is no evidence that Northern has paid a price to a third party supplier of gas in excess of the specific prices otherwise provided in the Supplement excluding the application of clause 6(b). Considering these circumstances,

the contract is one that could result and did result in extreme hardship to the public.

46. Section 105 of the Natural Gas Policy Act of 1978 imposes a ceiling price on Beaver Creek gas commencing December 1, 1978. That ceiling is the lesser of the NGPA Section 102 price applicable to "new" natural gas, or the price under the terms of the contract. The "new" natural gas price adopted by reference therein increases monthly by virtue of an inflation index plus a factor designed to escalate the "new" gas price to the heating value equivalency of fuel oil by January 1, 1985. The "new" gas base price plus allowable tax reimbursement, adjusted to reflect the BTU of Beaver Creek gas, was approximately $2.80 per Mcf at the time of trial. On January 1, 1985 "new" gas will be deregulated. Intrastate gas such as Beaver Creek will also be deregulated on January 1, 1985, unless its price is then being fixed under an indefinite price escalator clause such as clause 6(b). The producers have taken the position that they are entitled to collect the highest price legally permissible. Although Beaver Creek gas is now subject to a ceiling price, there is no assurance it will continue to be so restricted.

47. The cost of Beaver Creek natural gas to consumers served by Northern has increased from a price of approximately 28¢ per Mcf in December of 1975 to a price of approximately $2.80 per Mcf in April, 1980, an increase in slightly over four years of 10 times the price specifically bargained for under Articles 5 and 7 of the contracts. For the consumer a monthly gas bill of $30 has been increased to approximately $250 and is still increasing under clause 6(b) as claimed by the producers.

48. Out of the specific fee or transportation allowance payable to Northern for gas delivered to Casper refinery, Salt Creek and Winkelman Dome, Northern must bear the cost of line loss which averages two percent of the gross quantities transported. If clause 6(b) is enforced, the cost to Northern of the two percent line loss would exhaust the entire transportation allowance of 5¢ per Mcf for transportation of the gas

delivered from Beaver Creek to Amoco's Standard Refinery at Casper, Wyoming and such transportation would be provided by Northern at a loss.

49. The evidence in the record does not support the interpretation of clause 6(b) to include a right to reimbursement of ad valorem taxes assessed against the producers. Article 16 of the contracts is not specifically changed or amended by clause 6(b) nor are any adjustments to price included therein. The substituted Exhibit 11 of the producers reflects producers' claims of a right to recover from Northern the amount of ad valorem taxes which were reimbursed to third-party sellers under FPC provisions applicable to the interstate sale even though higher than ad valorem taxes on Beaver Creek gas. The Court finds no factual basis to permit the producers to recover ad valorem taxes paid by a third party on production not related to Beaver Creek.

## CONCLUSIONS OF LAW

1. This Court has jurisdiction of the parties and of the subject matter in this action pursuant to 28 U.S.C. § 1332.

2. Once the Public Service Commission has accepted for filing a gas purchase contract, the cost of gas thereunder is recoverable as a matter of law through rates sufficient to pay such costs plus the cost of the utility service plus a reasonable rate on investment. Title 37, W.S. 1977. *Bluefield Waterworks & Improvement Co.* v. *Public Service Commission of West Virginia*, 262 U.S. 679, 692-693 (1923); *FPC* v. *Hope Natural Gas*, 320 U.S. 591, 603 (1944).

3. This case involves a substantial public interest, it appearing from the record that approximately 85% of the total gas acquired by Northern for resale to the public is limited to the gas it receives under the 1957 Gas Sales Contract as supplemented and that all such gas is sold principally to residential consumers in the communities of Lander, Riverton and Casper and intervening areas, and a part of such gas is sold to Northern Gas Company and results in increased prices to users in its

service area which includes Rawlins, Laramie and intervening communities.

4. The increase in price occurring since clause 6(b) became effective from approximately $0.28 per Mcf to the current $2.80 per Mcf has the effect of increasing the residential consumers' monthly gas bill from an assumed $30 per month to a figure of approximately $250 per month. The cost of converting a natural gas heating system to an alternate fuel in a typical home in the areas served would require a capitalized expenditure of $2,500 or more.

5. The public interest is further demonstrated by the fact that all the parties in this case knew that the gas sold and committed under the Supplement (except for the portion purchased at Northern's cost by Amoco) would be resold to consumers who would be required to pay a price for such gas in excess of the price received by the producers from Northern as a regulated public utility.

6. Arles H. Barrett who negotiated the Supplement for Amoco testified that clause 6(b) was a new and unique clause and not one used in any other contract of which he had knowledge. It was designed and written (except for its effective date) by legal counsel on the staff of Amoco in Denver and was intended to provide that Amoco would be entitled to the highest possible price for the Beaver Creek gas based upon the highest price paid for any gas produced in Wyoming (except two counties) and sold in interstate commerce without regard to the fact that such highest price interstate gas might be priced as the result of higher BTU's (heating value), lower pressure base, higher taxes included in the price, and also without regard to extraordinary FPC price allowances contrary to the national public policy except for special conditions not common to Beaver Creek gas nor to the producers.

7. The intention and demands of Amoco, Phillips and Kerr-McGee for prices exacted from Northern Utilities, Inc. were designed to and will result in an inequitable, illegal and oppressive result, causing rate payers in the areas served to be

charged exorbitant prices for the natural gas involved in this case. Clause 6(b), as intended by the producers and as now interpreted by them, was unconscionable and against public policy in its design at its inception and since then their intentions have been corroborated by the results.

8. The public interest is further demonstrated by the fact that Amoco recognized the steepening spiral of prices and hardships resulting to public consumers by suggesting a phase-in price. The evidence pertaining thereto shows that the purpose of the phase-in was to assist Amoco in its public relations and not to serve the interests of the public consumer. Amoco in argument before this Court has reverted to its contention that it is entitled to the highest price possible under clause 6(b) in spite of Amoco's voluntary election to phase in such highest prices over a period of 18 months.

9. The central issue in this case is whether under the powers of equity and the provisions of § 34-21-219 W.S. 1977, this Court should strike down clause 6(b) as void against public policy and unconscionable at the time the parties entered into the contract and enforce the remainder of the contract with clause 6(b) omitted therefrom.

10. Ordinarily it is desirable that parties be protected in their right to make and enforce agreements between themselves, but this right is limited by the rule that an agreement must not be contrary to public policy. *Adkins* v. *Children's Hospital*, 261 U.S. 525 (1923).

11. The Courts will deny enforceability of a contract provision that clearly contravenes the public right or the public welfare or gravely violates paramount requirements of public interest. *Chicago and North Western Railway Co.* v. *Rissler*, 184 F.Supp. 98 (Wyo. 1960), *Northwest Airlines, Inc.* v. *Alaska Airlines, Inc.*, 351 F.2d 252 (9th Cir. 1965).

12. It is a fundamental doctrine that the extent to which a court of equity may grant or withhold its aid and the manner of molding its remedies is dictated by the public interests involved. *United States* v. *Morgan*, 307 U.S. 183 (1939).

13. The courts of equity will refuse to decree specific performance of a contract provision where the result would be unconscionable or unjust. *U.S.* v. *Georgia Pacific Co.*, 421 F.2d 92 (9th Cir. 1970), *Union Pacific Railroad Co.* v. *Chicago R.I.&P.R. Co.*, 163 U.S. 564 (1896), *Campbell Soup Co.* v. *Wentz*, 172 F.2d 80 (3rd Cir. 1948). Courts of equity will not assist a party seeking to enforce a hard bargain. *Keller* v. *California Liquid Gas Corp.*, 363 F. Supp. 123 (Wyo. 1973).

14. A court should not hesitate to refrain from enforcing a contract provision when there is some overriding reason for public concern and the contract provision in some way causes real harm to the public. *Hudson Waterways Corp* v. *Coastal Marine Service, Inc.*, 436 F. Supp. 597 (E.D. Tex. 1977).

15. The United States Supreme Court has indicated that indefinite escalator clauses by their design and function alone may be "incompatible with the public interest." *In Re Permian Basin Area Rate Cases*, supra, at pg. 783 (1968).

16. This Court finds as a matter of law that clause 6(b) as it is interpreted by the producers, viewed in the light of the producers' intentions at the time each executed the Supplement and evidenced by their actions in demanding the highest price paid for any gas sold in interstate commerce without regard to substantial differences in such gas and the conditions precedent to such high prices being authorized, is a clause that is void as against public policy and unconscionable under § 34-21-219 W.S. 1977. Throughout the proceedings the producers have demanded that they be paid FPC prices designed and justified only for small producers when none of the producers could qualify as a small producer under the regulations which permitted such bonus price to be paid. This is contrary to the policy of the United States, whose special allowances were specifically withheld from gas sold in interstate commerce but equivalent in all other respects to the gas involved in this case.

17. The case of *Bradford* v. *Plains Cotton Cooperative Assn.*, 539 F.2d 1249 (10th Cir. 1976) presented a factual situation unlike the facts in the instant case. In the *Bradford*

case, farmers who raised cotton had made forward contracts for the sale of cotton to a cooperative. The contracts for the sale of cotton were made for specific price pursuant to a schedule for cotton to be delivered within a specific time, namely, the growing season. The cotton buyer could and did protect itself by promptly selling cotton or cotton futures to avoid risk. The cotton contracts ran for a period of six months. Unlike the clause in *Bradford*, clause 6(b) in the instant case operates for a period of twelve years. Northern cannot sell futures in natural gas nor sell surplus gas from Beaver Creek, the only market being an interstate market, and the contract itself forbids a sale of Beaver Creek gas in the interstate market. In the *Bradford* case the parties could not foresee and did not contemplate that the government might lift the acreage restriction on cotton planting. In the instant case the producers are substantial producers in the nation-wide natural gas producing industry, and they were aware of the then current proposals to change ceiling prices and methods concerning them as stated in the notices of the FPC in June and July 1970 (Exhibits J and K). Phillips and Kerr-McGee had much later knowledge of the prospects for drastic increases since they signed the Supplements in 1973. In the instant case there is no contention by the producers that the prices under Article 5, adjusted by Article 7, were unfair. But since the provisions of clause 6(b), as intended by the producers, would remove all price restraints from the contract and fix a then indefinite price that would result in windfalls to the producers and would result in unjustly burdensome and harsh results to the consumers, clause 6(b) was unconscionable at the time of its making. In the *Bradford* case the cotton buyer experienced a gain in income under the cotton contracts of less than nine-tenths of one percent. In the case at bar the producers were profitably selling natural gas at $0.28 per Mcf, and now demand ten times that figure, an increase of 900% or more. Finally, the sale of cotton in the *Bradford* case did not involve a public interest; while the case at bar involves a substantial public interest. This Court is persuaded that the *Bradford* case is distinguishable from the case at bar on its facts.

18. The case of *Amoco Production Co.* v. *Stauffer Chemical Company of Wyoming*, (Wyoming Supreme Court Docket No. 5257—Opinion published June 9, 1980) presented a factual situation unlike the one presently before us. No argument was made in *Stauffer* that the particular clause involved in that case was unconscionable or against the public interest. The fact that the Wyoming Supreme Court upheld the favored nations clause found in *Stauffer* is of little consequence in this situation. The Court has the ability to pass directly on the unconscionability of each individual contract or particular clause therein in light of the general commercial background and needs of each case and to limit unconscionable contract provisions so as to avoid unconscionable results. § 34-21-219 W.S. (1977) and official comments to the Uniform Commercial Code.

19. Favored nations clauses "naturally grant an advantage to the seller. As such, they have generally been construed in favor of the buyer and against the seller. Neither the courts, nor regulatory agencies dealing with such clauses, have looked upon them with favor. . . . There need be no economic or other substantial justification for the increase." *Superior Oil Company* v. *Western Slope Gas Co.*, 604 F.2d 1281, concurring Opinion at pg. 1295 (10th Cir. 1979).

20. The indefinite escalation clause in this instance causes price increases to occur without reference to the economics and circumstances of the particular operation. *Permian Basin Area Rate Cases*, supra.

21. As such, paragraph 6(b) causes windfall profits and substantially increases the cost to consumers for a commodity without which they may well not be able to live. The impact of such escalations could well be devastating on the general public in the communities served by Northern. *Superior Oil Company* v. *Western Slope Gas Company*, supra, concurring opinion at pg. 1296 (10th Cir. 1979).

22. When a provision of a contract is void as against public policy or unconscionable, the Court may enforce the remainder of the contract without the undesired clause. *Driessen* v. *Fre-*

*borg*, 431 F. Supp. 1191 (N.D. 1977), *Union Tank Car Co.* v. *Lindsay Soft Water Corp. of Omaha, Inc.*, 257 F. Supp. 510 (D.C. Neb. 1966), § 34-21-219 W.S. (1977).

23. With respect to clause 6(a) in the Supplement, there is no contention that any price has been activated thereby nor any issue of fact existing therewith. Northern moved to dismiss any claim concerning clause 6(a) without prejudice. The Court concludes that clause 6(a) should remain in the contract in the event that it may activate higher prices in the future, subject at that time to a determination of the question then presented whether it is valid and enforceable under such facts and circumstances as the evidence at that time may disclose.

24. The payments demanded of and paid by Northern Utilities, Inc. to Amoco and in turn to Phillips and Kerr-McGee under said clause 6(b) were illegal, and the amounts so paid in excess of the price determined under the other provisions of the 1957 contract as supplemented should be refunded to Northern Utilities, Inc. who, in turn, has agreed to make refunds to its rate payers in accordance with orders of this Court and the Public Service Commission of Wyoming.

25. Judgment shall be entered in conformane with these Findings of Fact and Conclusions of Law.

Dated this 23rd day of October, 1980.

/s/ Clarence A. Brimmer
United States District Judge

# APPENDIX A-5

## Supplemental Judgment Of District Court Below

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF WYOMING

---

**No. C78-006-B**
**No. C78-081-B**
**Consolidated**

---

KERR-MCGEE CORPORATION, a Delaware corporation,
*Plaintiff,*

v.

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Defendant.*

---

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Plaintiff,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation,
and PHILLIPS PETROLEUM COMPANY,
a Delaware corporation,
*Defendants.*

---

FILED
NOV. 20, 1980

### SUPPLEMENTAL JUDGMENT

The above-captioned matter came on for hearing before the Court on November 7, 1980, for determination of the amount of overpayments, interest thereon and security or supersedeas bonds to stay the judgment and supplemental judgment during the pendency of an appeal, Amoco Production Company appearing by and through its attorneys, John S. Pfeiffer and R. H. Landt; Kerr-McGee Corporation appearing by and

through its attorney William T. Schwartz; Phillips Petroleum Company appearing by and through its attorney, Dale A. Mayer; Northern Utilities, Inc., appearing by and through its attorneys, Wm. H. Brown, Claude W. Martin and W. Bryce Arendt; and the parties having stipulated in open Court as to the amounts of principal and interest for which judgment is granted to Northern Utilities, Inc. and against each other party and the post-judgment interest rate after November 7, 1980 on the respective amounts of the judgment, and the Court being fully advised;

NOW, THEREFORE, and supplemental to the judgment herein of October 23, 1980, IT IS

ORDERED, ADJUDGED AND DECREED that Northern Utilities, Inc., recover of Amoco Production Company, the sum of $59,603,631.02. with interest thereon to November 7, 1980, in the amount of $6,772,704.14 for a total of $66,376,335.16; it is

FURTHER ORDERED, ADJUDGED AND DECREED that Northern Utilities, Inc. recover of Kerr-McGee Corporation, the sum of $3,549,202.07, with interest thereon to November 7, 1980, in the amount of $408,047.82 for a total of $3,957,249.89 it is

FURTHER ORDERED, ADJUDGED AND DECREED that Northern Utilities, Inc. recover of Phillips Petroleum Company, the sum of $4,605,734.34, with interest thereon to November 7, 1980, in the amount of $529,516.16 for a total of $5,135,250.50 it is

FURTHER ORDERED, ADJUDGED AND DECREED that the judgment in the total amount of $75,468,835.55, herein granted to Northern Utilities, Inc. against said parties in their respective total amounts stated above shall bear interest at the rate of 10% per annum from and after November 7, 1980 until paid; it is

FURTHER ORDERED pursuant to stipulation of the parties in open Court and Rule 8 of the Federal Rules of Appellate

Procedure, that if Amoco Production Company, Kerr-McGee Corporation, and Phillips Petroleum Company perfect an appeal from said judgment of October 23, 1980 as supplemented hereby, they may file with this Court, in form approved by counsel for Northern Utilities, Inc., a duly executed, written guaranty of payment to Northern Utilities, Inc. of the full amount of the judgment plus interest against each of said parties, respectively, which shall be in lieu of a supersedeas bond or other security to stay the judgment as supplemented hereby; and it is

FURTHER ORDERED, ADJUDGED, AND DECREED that the terms and provisions of this supplemental judgment are incorporated into the judgment entered herein on October 23, 1980 the same as if set forth therein.

Dated this 20th day of November, 1980.

/s/ Clarence A. Brimmer
United States District Judge

# APPENDIX A-6

## Uniform Commercial Code, Comments To Section 2-301, American Law Institute (1962)

### OFFICIAL COMMENT

Prior Uniform Statutory Provision: None

Purposes:

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga. App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v.

Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new car," a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P.273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of

clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

# APPENDIX A-7

## Article 6(b) To The Contracts In This Case*

### ARTICLE 6(b)

From and after January 1, 1976, when the price to be paid by Northern to Pan American pursuant to the other provisions hereof is less than the sum of the price received for gas being sold in interstate commerce, by any producer within the State of Wyoming, except in the counties of Uinta and Lincoln, plus three cents per one thousand cubic feet (3¢/MCF), then Northern shall increase the price to be paid Pan American hereunder to a price equal to the price being received by such producer plus three cents per MCF.

---

* It should be noted that the reference to "Pan American" in the clause refers to Pan American Petroleum Corporation, the corporate predecessor of Amoco. The language of the clauses in the Kerr-McGee and Phillips contracts is identical except their names are substituted for that of Pan American.

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No. 82-434

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1982

---

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

v.

KERR-MCGEE CORPORATION, a Delaware corporation,
*Respondent.*

---

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation and PHILLIPS PETROLEUM COMPANY, a Delaware corporation,
*Respondents.*

---

**Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

---

## SUPPLEMENTAL APPENDIX

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WILLIAM H. BROWN
500 Petroleum Building
Casper, WY 82601
(307) 265-9210
*Counsel of Record for Northern Utilities, Inc., Petitioner*

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D.C.

IN THE

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OCTOBER TERM, 1982

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*Respondents*.

---

**Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

---

## SUPPLEMENTAL APPENDIX

---

Rule 28.1 of the Rules of the Supreme Court of the United States, as revised on November 21, 1980, requires that a Petitioner for a Writ of Certiorari provide a listing naming all parent companies, subsidiaries, and affiliates.

The Petitioner, Northern Utilities, Inc., is a wholly-owned subsidiary of Kansas-Nebraska Natural Gas Company, Inc. It has no subsidiaries of its own.

The other subsidiaries of Kansas-Nebraska Natural Gas Company, Inc. are the following corporations:

Northern Gas Company
Northern Mountain Gas Company
Western Gas Corporation
Cap-Con International, Inc.
Western Alfalfa Corporation
Excelsior Oil Corporation
Midlands Gas Corporation
Helium, Inc.
Wyoming Fuel Company
North Central Energy Company
Midlands Transportation Company
Slurco, Inc.
Slurco Corporation

Respectfully submitted,

WILLIAM H. BROWN
BROWN, DREW, APOSTOLOS,
MASSEY & SULLIVAN
500 Petroleum Building
Casper, WY 82601

*Counsel of Record*
*for Petitioner*

September 27, 1982

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AMOCO PRODUCTION COMPANY, a Delaware corporation and PHILLIPS PETROLEUM COMPANY, a Delaware corporation,
*Respondents.*

On Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

## BRIEF OF KERR-McGEE CORPORATION AND PHILLIPS PETROLEUM COMPANY IN OPPOSITION TO PETITION FOR CERTIORARI

PETER J. NICKLES
*Counsel of Record*
PERRIN R. LOVE
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
P.O. Box 7566
Washington, D.C. 20044
WILLIAM T. SCHWARTZ
SCHWARTZ, BON, McCRARY & WALKER
506 Consolidated Royalty Building
Casper, Wyoming 82601
RICHARD R. WILFONG
JAMES W. ROBERTS
KERR-McGEE CORPORATION
Kerr-McGee Center
123 Robert S. Kerr Avenue
Oklahoma City, Oklahoma 73125
*Attorneys for Respondent Kerr-McGee Corporation*

THOMAS M. BLUME
*Counsel of Record*
FRANK A. ACKERMAN
PHILLIPS PETROLEUM COMPANY
7800 East Dorado Place
Englewood, Colorado 80111
HOUSTON G. WILLIAMS
WILLIAMS, PORTER, DAY & NEVILLE, P.C.
Suite 300, Durbin Center Building
145 South Durbin
Casper, Wyoming 82601
*Attorneys for Respondent Phillips Petroleum Company*

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**On Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

---

## BRIEF OF KERR-McGEE CORPORATION AND PHILLIPS PETROLEUM COMPANY IN OPPOSITION TO PETITION FOR CERTIORARI

---

This Brief in Opposition to the Petition for Certiorari is filed by respondents Kerr-McGee Corporation ("Kerr-McGee") and Phillips Petroleum Company ("Phillips"), who were appellants in the court below.[1]

---

[1] Subsidiaries and affiliated companies of Kerr-McGee and Phillips appear in the Appendix.

## PERTINENT STATUTES

Section 105 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3315, and Section 34-21-219 of the Wyoming Statutes (1977) are printed at pp. 2-4 of the Petition.

Section 601(b)(1)(A) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431(b)(1)(A) states:

> (b) Charges deemed just and reasonable.—
>
> (1) Sales.—
>
> (A) First sales.—Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—
>
> (i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or
>
> (ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

## COUNTERSTATEMENT OF THE CASE

This is a diversity suit to resolve the validity of a third-party favored nations clause contained in supplemental agreements to three long-term natural gas supply contracts. A third-party favored nations clause is a type of automatic price escalator which requires the purchaser to pay the highest price that any other purchaser pays for natural gas in a designated area. Such clauses are customarily included in long-term natural gas supply contracts. They ensure a distributor of a continuing supply of natural gas for its customers, and ensure a producer that the contract price keeps pace with rising prices and costs over the life of the contract. The clause at issue here authorized progressively higher contract prices as interstate gas prices rose during the 1970's.

In 1957, the corporate predecessor of Amoco Production Co.[2] began supplying natural gas to Northern Utilities, Inc., from the Beaver Creek field in Fremont County, Wyoming. The next year, Kerr-McGee Corp. and Phillips Petroleum Co. became joint participants with Amoco in the Beaver Creek field. Kerr-McGee and Phillips each entered contracts almost identical to the Amoco contract[3] to supply natural gas to Northern Utilities from the Beaver Creek field. All sales under the contracts were entirely intrastate. Each contract extended for twenty years, and included a two-party favored nations clause which entitled each producer to receive the highest price that Northern Utilities paid any other producer of gas in Wyoming. Each contract also gave Northern Utilities a preferential right to negotiate in the future to purchase excess gas that might become available from the Beaver Creek field.

In April, 1970, Amoco notified Northern Utilities that excess gas was available for sale. During the ensuing months Amoco and Nothern negotiated a supplemental agreement to the original 1957 contract, which they signed on October 1, 1970. The supplemental agreement extended the length of the original contract 12 years, through 1990, and ensured Northern Utilities of a continuing supply of gas for its customers at a time when natural gas reserves were dwindling and competition for existing reserves was increasing. In return, Northern Utilities and Amoco added Article 6(b), a third-party favored nations clause, to the pricing provision of the original contract. Article 6(b) entitled Amoco to receive

---

[2] Hereafter referred to as Amoco without distinction.

[3] The differences are not relevant to this Petition.

on sales of gas to Northern Utilities the highest price which any producer in Wyoming (with the exception of two counties) received on sales of gas, plus 3¢ McF.

About a year after the supplemental agreement between Amoco and Northern Utilities took effect, Northern Utilities proposed that Kerr-McGee and Phillips enter similar agreements to supply natural gas through 1990. By letter of Sept. 9, 1971, Northern Utilities forwarded to Kerr-McGee and Phillips copies of proposed agreements which included a third-party favored nations clause identical to the clause in the Amoco agreement. By letter of Dec. 3, 1971, Northern Utilities urged Kerr-McGee and Phillips to complete the agreements so that Northern could close its files before the end of the year. Kerr-McGee and Phillips reviewed the documents over the ensuing months, but did not agree to Northern's terms. By letter of Sept. 11, 1972, Northern proposed modifications not relevant to this litigation; the agreements continued to include the third-party favored nations clause. Northern urged Kerr-McGee and Phillips to accept the terms and return executed copies. Eventually, on February 23, 1973, Kerr-McGee agreed to Nothern's terms, and entered a supplemental agreement that included a third-party favored nations clause. Two months later, on May 4, 1973, Phillips agreed to Northern's terms and entered a similar supplemental agreement. The third-party favored nations clause was designated Article 6(b) in each agreement.

Beginning in 1976, the Federal Power Commission[4] authorized price increases for interstate sales of natural gas. As other producers in Wyoming increased their

[4] Now the Federal Energy Regulatory Commission.

prices to authorized levels, Article 6(b) was triggered. Amoco, Kerr-McGee, and Phillips became entitled to receive from Northern Utilities a price equal to the highest price other Wyoming producers received for interstate sales of natural gas, plus three cents per McF. Northern requested and received approval from the Wyoming Public Service Commission for a rate increase to meet the contract price.

Amoco agreed to phase-in the contract price through July 1, 1978, at which time Article 6(b) would become fully effective. Kerr-McGee and Phillips refused to phase-in the price to which they were entitled under 6(b), and Kerr-McGee brought suit to recover the difference between the phase-in price and the contract price. Northern counterclaimed and brought suit against Amoco and Phillips; the actions were consolidated. Subsequently, the Natural Gas Policy Act of 1978 (NGPA) placed a ceiling on the price of gas sold intrastate equal to the maximum lawful price established under the Act for new natural gas sold interstate. As other producers raised prices to maximum price levels, Article 6(b) in effect entitled the producers to receive the highest price which any producer in Wyoming received on interstate sales of gas, without the three-cent surcharge.

The trial court held the third-party favored nations clause unconscionable under Wyoming law, Wyo. Stat. § 34-21-219 (1977),[5] because the clause imposed "exhorbitant" prices on rate payers. Pet. App. 38a-39a. The trial court also held that the clause violated public policy, but did not specify whether state or federal public policy

[5] The Wyoming unconscionability statute adopts U.C.C. § 2-302 without change.

was violated. *Id.* The court struck the clause and enforced the pricing provisions of the original contracts. Pet. App. 42a-43a. By supplemental judgment, the court awarded Northern Utilities recovery for past payments in excess of the court imposed price: $59,603,631.02 plus interest against Amoco; $3,549,202.07 plus interest against Kerr-McGee; and $4,605,734.34 plus interest against Phillips Petroleum. Pet. App. 44a-45a. Because the court imposed the original contract price on the remaining years of the contract, the monetary effect of the ruling would have been even greater for the future term of the contract.

The Tenth Circuit Court of Appeals reversed unanimously. The Court of Appeals held, first, that Article 6(b) comports with federal public policy because the Natural Gas Policy Act (NGPA) authorizes producers to escalate the price of intrastate gas to statutory price ceilings through indefinite price escalators. Pet. App. 6a-9a. The Court also held that Article 6(b) comports with Wyoming public policy, observing that the Wyoming Supreme Court had enforced a favored nations clause despite a challenge on public policy grounds in *Amoco Production Co.* v. *Stauffer Chemical Co.*, 612 P.2d 463 (Wyo. 1980). Pet. App. 9a-11a. Finally, the Court held that Article 6(b) was not unconscionable under Wyoming law, stating among other things, that no evidence was introduced that Northern Utilities was unable to negotiate freely, or was compelled to accept the terms of the supplemental agreements. The Court noted that Article 6(b) was a *quid pro quo* for the twelve-year extension of the original contracts, which enabled Northern Utilities to guarantee a continuing supply of natural gas to its customers. Pet. App. 12a-16a.

## ARGUMENT

### 1. No Constitutional Or Important Federal Questions Are Presented.

The Petition presents no considerations that warrant review by this Court on *certiorari*. The Tenth Circuit Court of Appeals decision addresses no constitutional questions and conflicts with no decisions of any other court, state or federal. The decision also presents no important federal question. The unconscionability and Wyoming public policy questions are governed entirely by state law. Even the federal public policy question turns on state law in this case, because the Petition alleges that the sufficiency of an indefinite price escalator clause under the NGPA "must be determined under state contract law." Pet. 31. And the Court of Appeals' analysis of federal public policy is fully in accord with the Fifth Circuit, *see Pennzoil Co.* v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 1000 (1982), as well as other decisions within the Tenth Circuit, *see Superior Oil Co.* v. *Western Slope Gas Co.*, 604 F.2d 1281 (10th Cir. 1979); *Amoco Production Co.* v. *Kansas Power & Light Co.*, 505 F. Supp. 628 (D. Kan. 1980).

Further, the unconscionability question, and therefore the federal public policy question, is factual. The Petition characterizes the unconscionability question as "whether the Court of Appeals erred in neglecting to consider the following six facts." Pet. i. Immediately prior to its conclusion, the Petition again states that "[i]t is the facts of the case at bar which the Court of Appeals has overlooked and did not consider. Facts which disclose an unconscionable clause contrary to the public interest." Pet. 32. Stripped to essentials, the Petition seeks an evidentiary review of the record simply because the Court of Appeals ruled against Northern Utilities on the merits. This court

ordinarily does not grant certiorari to review evidence. *See, e.g., United States* v. *Johnston*, 268 U.S. 220, 227 (1925).

**2. The Court Of Appeals Decided Each Issue Correctly.**

**a.** ***Unconscionability***

The Court of Appeals held that the trial court misapplied the legal standard of unconscionability under Wyoming law, because the trial court based its conclusion solely on the rise of the contract price beginning more than three years after contracts were made, not on circumstances at the time of contracting.[6] The Court of Appeals did not, as the Petition alleges at 11, view the record as a "simple case of rising market price," without considering other circumstances. In fact, the Court of Appeals judged unconscionability precisely by the factors enumerated in the leading Wyoming decision on unconscionability, *In re Estate of Frederick*, 599 P.2d 550 (Wyo. 1979), a decision which the district court "inexplicably" failed to cite or consider. Pet. App. 12a. Applying the *Frederick* factors,[7] the Court of Appeals concluded that "experienced negotiators for both parties entered into an agreement after several months of give-

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[6] The increases authorized under Article 6(b) began three years after Kerr-McGee and Phillips entered the supplemental agreements; they began six years after Amoco negotiated its supplemental agreement.

[7] The factors enumerated in In re Estate of Frederick include whether the party alleging unconscionability (1) was presented with a meaningful choice; (2) was compelled to accept the contract terms; (3) had an opportunity for meaningful negotiations; or (4) suffered such a gross inequality of bargaining power that negotiations were not possible. 599 P.2d at 556.

and-take. Northern was not compelled to enter into the contract and clearly believed the contract terms were to its advantage at the time of execution and for several years thereafter." Pet. App. 16a. Northern Utilities fully briefed and argued before the Court of Appeals the circumstances it believes were ignored. The Court of Appeals concluded after a review of the record that no evidence was introduced that constituted unconscionability as defined in *In re Estate of Frederick*. Nothing in the Petition alters this conclusion.[8]

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[8] The circumstances on which the Petition primarily relies boil down to the fact that Article 6(b) contains no adjustments for pressure base or Btu content. The Petition alleges that the absence of such adjustments makes Article 6(b) "unique," Pet. 12, and oppressive and one-sided, Pet. 25-26. The Petition also alleges that Amoco "misled" Northern Utilities to believe that Article 6(b) contained adjustments for pressure base and Btu content by threatening to sell Beaver Creek gas to an interstate pipeline. Pet. 16-17. The Petition fails to explain why uniqueness is relevant to unconscionability; in any event, Article 6(b) is no different in effect than the third-party favored nations clause enforced by the Wyoming Supreme Court in Amoco Production Co. v. Stauffer Chemical Co., 612 P.2d 463 (Wyo. 1980). The allegation that Amoco "misled" Northern Utilities evidences nothing more than vigorous bargaining by Amoco. No terms were hidden, no misrepresentations made. Northern's representatives were fully capable of concluding from the language alone that Article 6(b) did not include any adjustments. Further, the absence of adjustments does not make the contract price oppressive or one-sided. In enforcing the third-party favored nations clause in *Stauffer Chemical, supra*, the Wyoming Supreme Court refused to limit the clause to the highest price paid for gas *of the same vintage*. The Court stated that "the contract price is not restricted to that prescribed to be paid for the gas sold under contract if it were sold in interstate commerce pursuant to [FPC] order," *id.* at 466, and recognized that the purpose of the clause was to provide for the "*highest* price being paid for the commodity by any other purchaser." *Id.* at 468 (emphasis in original). Similarly, the Tenth Circuit has recognized that the price

The conclusion of the Court of Appeals is even stronger with regard to Kerr-McGee and Phillips Petroleum. No evidence whatever of unconscionable conduct in the formation of the contract was introduced at trial against Kerr-McGee or Phillips.[9] Kerr-McGee and Phillips did not bargain over the third-party favored nations clause, but accepted the terms *as proposed by Northern Utilities*.

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of gas is not tied to the cost of production. *See* Superior Oil Co. v. Western Slope Gas Co., 604 F.2d 1281, 1291 n.15 (10th Cir. 1979) (The "value of gas is [not] directly related to the cost of production. Supply and demand are the conventional determinants. . . . The actual value of a product is determined by what people will pay for it, not what it costs to produce.").

The Petition also asserts that two other circumstances evidence unconscionability—Amoco's attempts to recover from Northern Utilities production taxes paid, Pet. 15, and the resale of gas from Northern Utilities back to Amoco, Pet. 20. Again, however, Northern Utilities fails to demonstrate how these circumstances deprived it of the ability or opportunity to negotiate freely. The original 1957 contract required Northern Utilities to reimburse Amoco for a percentage of production taxes paid. Several years after the supplemental agreement was signed, Amoco asserted a right to recover from Northern Utilities ad valorem taxes reimbursed to other producers by other buyers. Amoco asserted that such taxes should be considered part of the contract price under Article 6(b). Amoco's attempt to recover the taxes does not represent overreaching or unfair surprise, but a genuine legal dispute as to whether Article 6(b) governed the tax reimbursement provision of the original 1957 contract. Finally, Northern's agreement to sell gas back to Amoco was entirely separate from the supplemental agreement. The resale agreement did not induce Northern Utilities to enter the supplemental agreement against its will, and Amoco hardly could have deceived Northern Utilities about its existence.

[9] The evidence of bargaining conduct introduced against Amoco was expressly excluded from evidence introduced against Kerr-McGee and Phillips. (Record, Vol. XIII, p. 263.)

Northern Utilities initiated discussion with both Kerr-McGee and Phillips. Northern Utilities provided all the terms and repeatedly urged Kerr-McGee and Phillips to enter the supplemental agreements. After Kerr-McGee agreed to Northern's terms, Northern continued to urge Phillips to agree to Northern's terms until Phillips did so. A party to a contract who does not negotiate cannot oppress, mislead, or unfairly surprise the other party.

b. ***Wyoming Public Policy***

The Court of Appeals also concluded correctly that the third-party favored nations clause is fully consistent with Wyoming public policy. The Court followed the clear expression of Wyoming public policy stated by the Wyoming Supreme Court in *Amoco Production Co.* v. *Stauffer Chemical Co.*, 612 P.2d 463 (Wyo. 1980), which enforced a third-party favored nations clause very similar in effect to Article 6(b).[10] The Court of Appeals also noted that the Wyoming legislature had imposed no restrictions on the operation of indefinite price escalators. Pet. App. 10a-11a. The Court of Appeals would have raised serious *Erie* concerns if it had ignored the specific language of the Wyoming Supreme Court in the absence of any ex-

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[10] The Wyoming Supreme Court stated in *Stauffer Chemical:*

> *Favored nations clauses are a common feature of gas purchase and sale contracts.* The nature of the product and its questionable availability engenders reluctance on the part of producers to enter into long term contracts at the price prevailing at the time of the contract. Yet purchasers require long term commitments to insure an adequate supply of gas. . . . A third-party favored nations clause requires the purchaser to match any higher price contracted to be paid by any other buyer in the same field or area. *Favored nations clauses are recognized in the courts.*

612 P.2d at 468 (emphasis added) (citations and footnotes omitted).

pression to the contrary. The trial court cursorily distinguished the *Stauffer Chemical* decision,[11] but offered no other source of Wyoming public policy. Pet. App. 42a. The Petition offers no other source of Wyoming public policy except the participation of the state Attorney General in this litigation *amicus curiae*. Pet. 28. The *amicus* participation of the Attorney General, of course, cannot constitute the public policy of a state. Public policy is determined from the state's constitution and statutes, and from judicial decisions and administrative practice. *See Taylor* v. *State*, 612 P.2d 851, 865 (Wyo. 1980) (Rooney, J., concurring).

The Petition attempts to evoke public policy concerns by asserting that Article 6(b) significantly raised the price paid by Northern's customers. Aside from the legal inadequacy of the assertion, the effect of Article 6(b) on Northern's customers has been greatly exaggerated. The Petition cites the trial court's finding that Article 6(b) caused monthly gas bills to increase from $30 to $250 between 1975 and 1980. Pet. at 29, quoting Finding of Fact ¶ 47. The trial court inexplicably based this finding on the testimony of a Northern Utilities executive in

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[11] The trial court distinguished *Stauffer Chemical* on the ground that *Stauffer Chemical* did not specifically address the public policy question. Pet. App. 42a. The Petition forwards the same argument. Pet. 30. As the Court of Appeals noted, however, the public policy question was fully briefed and argued before the Wyoming Supreme Court in *Stauffer Chemical*. Pet. App. 10a. The Wyoming Supreme Court would not have enforced the third-party favored nations clause if it had concluded that the clause conflicted with Wyoming public policy. But the Court enforced the clause in all respects, stating that it would not follow a course that amounted to "rewriting the contract." 612 P.2d at 467.

response to a *hypothetical* question. The witness was asked to estimate a monthly gas bill in 1980 assuming the bill was $30 in 1975; the witness testified that *if* a consumer's monthly bill was $30 when the wellhead price was 28¢ per McF, the 1980 monthly bill would increase to between $285 and $300. (Record, Vol. VII, p. 339-40.) Testimony in the record, however, established that the monthly gas bill of a medium-size house at the time of trial in 1980 was *in fact* only $46.50.[12] Figures compiled by the American Chamber of Commerce confirm the evidence in the record. Consumers in Casper and Laramie, Wyoming, (both in Northern Utilities' service area) paid well below the national average for natural gas in the fourth quarter of 1980, when Northern was charging rates sufficient to pass through Article 6(b) gas prices. Consumers in Casper paid 78.8% of the national average, consumers in Laramie paid only 65.5%.[13]

The increase in consumer rates was not caused by the invidious motives of Kerr-McGee and Phillips, but by the same factors that caused the price of natural gas and other energy sources to rise dramatically during the 1970's—threats of natural gas shortages, increased production costs, the Arab Oil embargo and formation of OPEC, and the development of a national policy to pro-

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[12] The figure was derived from the actual price Northern Utilities charged at the time of trial, $3.12 per McF, and the witness's estimate that a medium-size house would use 180 McF per year (180 x $3.12 ÷ 12 = $46.50). (Record, Vol. VIII, pp. 475-76, 506.)

[13] *See* American Chamber of Commerce Researchers Ass'n., *Fourth Quarter 1980, Inter-City Cost of Living Indicators* (1980).

mote energy conservation.[14] Reconsideration of the Court of Appeals decision would not relieve Northern's customers of a special burden, but would grant them a special benefit which other consumers do not enjoy.

c. *Federal Public Policy*

Finally, the Court of Appeals correctly held that Article 6(b) is fully consistent with federal public policy as expressed in the NGPA. Section 3315 of the Act specifically permits the price of intrastate sales of natural gas to rise to ceiling levels according to the terms of indefinite price escalators. Section 3431(b)(1)(A) declares prices established by the statutory ceilings to be "just and reasonable." Administrative regulation and judicial decision confirm this policy. *See* 18 C.F.R. § 270.205(b)(1);[15] *Pennzoil Co.* v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied* 102 S. Ct. 1000 (1982).

The Fifth Circuit noted in *Pennzoil* that Congress was specifically aware of the use of indefinite price escalators in intrastate supply contracts when it enacted the NGPA. The Court concluded that the NGPA placed only four

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[14] *See, e.g.*, Opinion No. 770 at 10 (FPC, Sept. 27, 1976) (authorizing approximately 100% increases for the highest price of interstate gas because of "natural gas shortages," "shortages of other energy supplies" and substantial cost increases that "could not have been predicted").

[15] Section 270.205(b)(1) states (emphasis added):

> (b) *Existing intrastate contracts.* In the case of an existing contract (other than a contract to which paragraph (a) applies):
>
> (1) Except as provided in paragraph (b)(2) of this section, *any contractual provision for a change in price may operate according to the terms of such provision* except that such provision is not operative to authorize a seller to charge and collect an amount in excess of the highest applicable NGPA rate.

limitations[16] on the operation of indefinite price escalators in intrastate contracts, "thereby allowing escalator clauses to otherwise operate *according to their terms*." 645 F.2d at 378 (emphasis added). The Petition does not allege that the prices Kerr-McGee and Phillips receive under Article 6(b) exceed any of the limitations imposed by the NGPA, but only that Article 6(b) is somehow insufficient under the NGPA because it is unconscionable under Wyoming law. Pet. 31. Because the prices received do not exceed NGPA limitations, Article 6(b) comports with federal public policy.

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[16] The four limitations are: (1) prices established by indefinite price escalators cannot exceed the maximum lawful prices established in § 3315(b)(1) and (2); (2) prices established by indefinite price escalators which equal the maximum lawful price are subject to continuing regulation after Dec. 31, 1984 (§ 3315(b)(3)(A)); (3) an indefinite price escalator cannot escalate the price to "high cost" natural gas prices unless the gas qualifies as high cost gas (§ 3373(a)); and (4) an indefinite price escalator cannot escalate the price to emergency sale or emergency allocation prices (§ 3373(b)). *See* 645 F.2d at 376-78.

## CONCLUSION

For the foregoing reasons, the Petition should be denied.

Respectfully submitted,

PETER J. NICKLES
*Counsel of Record*
PERRIN R. LOVE
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
P.O. Box 7566
Washington, D.C. 20044

WILLIAM T. SCHWARTZ
SCHWARTZ, BON, MCCRARY & WALKER
505 Consolidated Royalty Building
Casper, Wyoming 82601

RICHARD R. WILFONG
JAMES W. ROBERTS
KERR-MCGEE CORPORATION
Kerr-McGee Center
123 Robert S. Kerr Avenue
Oklahoma City, Oklahoma 73125

*Attorneys for Respondent Kerr-McGee Corporation*

THOMAS M. BLUME
*Counsel of Record*
FRANK A. ACKERMAN
PHILLIPS PETROLEUM COMPANY
7800 East Dorado Place
Englewood, Colorado 80111

HOUSTON G. WILLIAMS
WILLIAMS, PORTER, DAY & NEVILLE, P.C.
Suite 300, Durbin Center Building
145 South Durbin
Casper, Wyoming 82601

*Attorneys for Respondent Phillips Petroleum Company*

## APPENDIX TO THE BRIEF IN OPPOSITION

**Phillips Petroleum Company Subsidiaries And Affiliates Not Wholly Owned As Of October 5, 1982**

Acurex Corporation
Acurex Solar Corporation*
Aero Oil Company
Alyeska Pipeline Service Company*
Arctic LNG Transportation Company*
Bruin Carbon Dioxide Sales Corporation*
Calatrava, Empress Para la Industria Petroquimica, S.A.*
Canada Western Cordage Company Limited
Cahyon Reef Carriers, Inc.*
Chisholm Pipeline Company*
Cochin Refineries Limited
Colonial Pipeline Company*
Compagnie Francaise du Carbon Black, S.A.*
Dixie Pipeline Company*
Everglades Pipe Line Company*
Explorer Pipeline Company*
Insurance and Reinsurance Brokers (Bermuda) Limited
Iranian Marine International Oil Company*
Kaw Pipe Line Company*
Kenai LNG Corporation*
Negronex, S.A.
Nordisk Philblack AB*
Norland Gmbh Fur Grundbesitz Und Industrieabulagen*
Norpipe a.s.*
Norpipe Petroleum UK Limited*
Norsea Gas A/S*
Norsea Gas Gmbh*
Norsea Pipeline Limited
Papago Chemicals, Inc.*
Petrochim
Phillips Carbon Black Company (Proprietary) Limited*

Phillips Carbon Black Italiana S.p.A.*
Phillips Carbon Black Limited
Phillips Gas Supply Corporation*
Phillips-Imperial Petroleum Limited*
Phillips Pacific Chemical Company*
Phillips Petroleum Singapore Chemical (Private) Limited*
Philmac Oils Limited*
Plasticos Vanguardia, S.A.*
Polar LNG Shipping Corporation*
Polyolefine*
Quimica Venoco C.A.*
Renolit-Fertighaus Gmbh*
The Salk Institute Biotechnology/Industrial Associates, Inc.*
Seadock, Inc.*
Seaway Pipeline, Inc.*
Sevalco (Holdings) Limited
Spodoco Limited*
Texas Offshore Port, Inc.*
Transatlantic Reinsurance Company
Trenwick Limited
Venezoil, C.A.
Western Desert Operating Petroleum Company
White River Shale Oil Corporation

* Indicates no public stock ownership.

**Kerr-McGee Corporation Subsidiaries And Affiliates Not Wholly Owned As Of October 5, 1982**

Kerr-McGee of Canada Northwest, Ltd.*
Kerr-McGee Oil (U.K.) Limited*
Marine Resources Insurance, Limited*
San-Ann Premium Center, Inc.
San-Ann Service, Inc.
Sunningdale Oils (ABU DHABI) Limited*
Sunningdale Oils (Ireland) Limited*
Transocean Drilling Company Limited
Transocean Drilling (Curacao) N.V.
Transshore Drilling Co. Limited
Transshore Drilling (Curacao) N.V.
White Shoal Pipeline Corporation
Basic Management, Inc.
Bikita Minerals (Private) Limited
Crescent Petroleum Company
Downtown Airpark, Inc.
Little Medicine Development Co.

* Indicates no public stock ownership.

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ALEXANDER L. STEVAS,
CLERK

IN THE

# Supreme Court of the United States

October Term, 1982

No. 82-434

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

*v.*

KERR-McGEE CORPORATION, a Delaware corporation,
*Respondent.*

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

*v.*

AMOCO PRODUCTION COMPANY,
a Delaware corporation and
PHILLIPS PETROLEUM COMPANY,
a Delaware corporation,
*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## BRIEF OF RESPONDENT, AMOCO PRODUCTION COMPANY, IN OPPOSITION TO PETITION FOR CERTIORARI

GORSUCH, KIRGIS, CAMPBELL, WALKER AND GROVER

ROBERT H. LANDT
Amoco Production Company
Amoco Building
Denver, Colorado 80202
Telephone: (303) 830-4689

JOHN S. PFEIFFER
1200 American National Bank Building
818 Seventeenth Street
Denver, Colorado 80202
Telephone: (303) 534-1200

*Attorneys for Respondent Amoco Production Company*

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## BRIEF OF RESPONDENT, AMOCO PRODUCTION COMPANY, IN OPPOSITION TO PETITION FOR CERTIORARI

## STATEMENT OF THE CASE

This case involves the interpretation of an intrastate gas sales contract between Respondent Amoco Production Company (Amoco) and Petitioner Northern Utilities, Inc. (Northern), and more particularly, the third-party favored nations clause in the contract. Such clauses are common in long-term gas sales contracts. The effect of the clause is to automatically escalate the price to be paid under the contract to the highest price being paid by any buyer to another seller in a given area. The purpose of the clause is to allow the purchaser to secure a long-term supply of natural gas while protecting the seller from the dangers inherent in long-term contracts at fixed prices.

The District Judge, after a trial to the Court, made his findings of fact and concluded that the third-party favored nations clause was void as against public policy and as unconscionable when made. He thereafter entered judgment against Amoco in the sum of $59,603,631.00 for reimbursement of payments previously made pursuant to said clause, and ruled that the clause was void and that the contract would remain otherwise in force and effect.

Like decisions were entered in favor of Northern and against Kerr-McGee Corporation (Kerr-McGee) and Phillips Petroleum Company (Phillips). Kerr-McGee and Phillips appealed these decisions and the three appeals were consolidated.

The Court of Appeals for the Tenth Circuit reversed the decision of the trial court. The Court of Appeals held that Northern had not demonstrated that the third-party favored nations clause was unconscionable under Wyoming law and that the clause was not contrary to either federal or Wyoming public policy.

## STATEMENT OF FACTS

On November 11, 1957, the predecessor of Amoco, Pan American Petroleum Corporation, entered into a Gas Sales Contract with Northern for the natural gas produced in Wyoming from the Beaver Creek field. The Producers of the gas in the Beaver Creek field are Amoco, Kerr-McGee and Phillips, with Amoco acting as operator. Like contracts were entered into between Northern and Kerr-McGee and Northern and Phillips. The contract's term was for twenty (20) years from the date of first delivery, and the price to be paid by Northern to Amoco was based on "each one thousand (1,000) cubic feet of gas taken." The base price per year of one thousand cubic feet (Mcf) is set forth in Article 5 and was subject to adjustment for inflation or deflation as provided in Article 7.

Article 6, entitled "*Favored Nations Clause*," provides for a price increase in accordance with a two-party favored nations clause and concluded:

> It is the intention hereof that the price to be paid Pan American hereunder shall at all times be equal to the higher of the following: (a) the price payable under Article 5 of this contract, as such price may have been changed by Article 7, or (b) the highest price paid by Northern to a producer of gas in the State of Wyoming.

By Article 3 of the contract, Northern irrevocably dedicates and commits the gas to its Wyoming markets, and the Article, after defining "Wyoming markets," provides:

> It is the intent hereof that the dedication set forth herein shall be strictly observed and maintained in conformance with the further provisions of this article and contract, to the end that the intrastate status of this sale shall at all times be maintained.

Northern was granted a preferential right to negotiate with Amoco "for a suitable contract and price covering" any excess gas Amoco had for sale during the term of the contract.

On April 7, 1970, Amoco, acting through Arles H. Barrett,[1] advised Northern that it had approximately sixty billion cubic feet of excess gas at Beaver Creek for sale, and, pursuant to Article 8 (d) of the Gas Sales Contract, invited Northern "to exercise your right to negotiate for the purchase of the additional gas quantity." Amoco desired to sell the excess gas during the remaining term of the agreement, that is, between 1970 and the end of 1977.

Northern, acting through Edwin Magagna,[2] accepted the invitation and between April of 1970 and October 1, 1970, Mr. Barrett, on behalf of Amoco and Mr. Edwin Magagna, on behalf of Northern, negotiated an amendment to the Gas Sales Contract. Each party presented oral and written proposals and drafts of the amended contract were being exchanged regularly. Northern did not want to take the excess gas during the term of the agreement, and negotiated for an extension of the term through 1990. The amendment was reduced to writing, dated October 1, 1970, and was executed by the parties. Article 5 (Base Price per Mcf) of the Gas Sales Contract was amended by adding thereto the base price per Mcf for the years 1979 through 1990.

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[1] Mr. Barrett has been an employee of Amoco and its predecessor since 1946. His formal education consists of two years of college. His experience is in the research department, field operations, gas measurement supervisor and a negotiator for sales of natural gas.

[2] Mr. Magagna was an attorney licensed to practice law in Wyoming with a number of years of experience in representing utilities. He was charged by Northern to negotiate on its behalf a written contract which would amend the 1957 agreement to reflect the acquisition of the additional gas.

Paragraph 4 of the amendment provides as follows:

> 4. The paragraph comprising present Article 6, Favored Nations Clause, is designated (a), and the following new paragraph (b) is added to said Article 6:
>
> '(b) From and after January 1, 1976, when the price to be paid by Northern to Pan American pursuant to the other provisions hereof is less than the sum of the price received for gas being sold in interstate commerce, by any producer within the State of Wyoming, except in the counties of Uinta and Lincoln, plus three cents per one thousand cubic feet (3¢/MCF), then Northern shall increase the price to be paid Pan American hereunder to a price equal to the price being received by such producer plus three cents per MCF.'

The last paragraph of the amendment required the submittal of the amended contract to the Public Service Commission of Wyoming for acceptance and filing. The amendment was delivered to the Public Service Commission of the State of Wyoming, accompanied by a statement of Northern prepared by Mr. Magagna to the Commission. That statement referred to the difficulty in obtaining long-term commitments and the advantages Northern believed it would receive under the amended contract. Thereafter, the Director, Utilities Department of the Public Service Commission of the State of Wyoming, advised Northern of the acceptance by the Commission. In 1973 like written amendments to their contracts were executed by Northern and Kerr-McGee and Northern and Phillips. These amendments were accepted for filing by the Public Service Commission.

In the year 1975, Northern was advised that the provision of 6 (b) of the Gas Sales Contract would be "triggered" as of January 1, 1976 by reason of the fact that prices being received by producers of gas in Wyoming per Mcf for sales in interstate commerce were exceeding the amount being paid to Amoco under the other provisions of the Gas Sales Contract. In December of

1975 Northern accordingly petitioned the Public Utilities Commission for an increase in rates. The Commission granted the increase. Amoco agreed to "phase in" the new prices until July 1, 1978 at which time the price escalator clause would be fully operative. Neither Kerr-McGee nor Phillips agreed to the "phased-in" prices.

As of December 1, 1978, the Natural Gas Policy Act came into effect, which limits the amount a producer may receive for the sale of intrastate gas to the lesser of the contract price and that which the producer could receive under Section 102 of the Act. The contract price (that is, the amount received by a Wyoming producer per Mcf for sales in interstate commerce plus three cents (3¢)) is higher than the Section 102 price. The ceiling price imposed by the Act is the amount due from Northern to Amoco.

In that it was receiving only the "phased-in" price for its gas, Kerr-McGee brought suit against Northern. In May of 1978, prior to the time when the prices were to be "phased-in," Northern brought suit against Amoco and Phillips. The two actions were consolidated for trial.

Northern initially claimed that Clause 6 (b) was ambiguous and contrary to public policy. On October 23, 1980, the trial court concluded that Clause 6 (b) was contrary to public policy and unconscionable. On March 23, 1982, the Court of Appeals for the Tenth Circuit reversed the decision of the trial court.

## SUMMARY OF ARGUMENT

Contrary to Northern's suggestions, the decision of the Court of Appeals below properly interprets the public policy of the United States and the State of Wyoming. Further, the Court of Appeals followed the controlling decision on unconscionability rendered by the Wyoming Supreme Court in upholding the favored nations clause at issue herein. Therefore, the Court of

Appeals has rendered a decision which neither conflicts with a state court of last resort nor departs from accepted judicial procedure.

There exists no compelling reasons for this Court to review this case and the Petition for Certiorari should be denied.

## ARGUMENT

### I.

### NORTHERN FAILED TO DEMONSTRATE THAT CLAUSE 6(b) WAS UNCONSCIONABLE AS A MATTER OF LAW.

Northern's contention that the Court of Appeals below failed to consider evidence which Northern relied upon at trial in asserting its claim of unconscionability is simply inaccurate. Each argument presented to this Court was raised by Northern in its briefs on appeal and addressed in oral argument. Further, in its opinion, the Court of Appeals explicitly acknowledged and rejected the reasons underlying the trial court's decision.

> The judge indicated that he found the price particularly offensive because it was unrelated to the cost of production, and was higher than the producers themselves could have received for the gas in an interstate sale. The producers could not qualify for the 'small producers' rate established for gas sales in interstate commerce, which was set at 130% of the ceiling rate established for large producers. *See* FPC Opinion No. 742 (August 28, 1975). However, paragraph 6 (b), by pegging the contract cost to the price received by *any* producer selling interstate gas, allowed the producers to receive the 'small producers' rate for interstate sales. Moreover, paragraph 6 (b) contains no vintaging distinction between old and new gas. The ceiling rates for old gas sold in interstate commerce are lower than those for new gas. *See American Pub. Gas Association v. FPC*, 567 F.2d 1016, 1033 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978). Through the operation of 6 (b), therefore, the producers here could

> receive the new gas rate for old gas. *See Amoco Production Company v. Stauffer Chemical Company*, 612 P.2d 463, 466 (Wyo. 1980).

Court of Appeals Slip Opinion at 8-9, n. 7. Rather than ignore the evidence in the case, the appellate court correctly found it insufficient as a matter of law to void the contract. Therefore, the trial court's decision was reversed.

The Court of Appeals properly held in accordance with Wyoming law "that unconscionability is tested as of the time the agreement is made and not in accordance with hindsight." *In Re Estate of Frederick*, 599 P.2d 550, 556 (Wyo. 1979). The doctrine of unconscionability is "one of 'prevention of oppression and unfair surprise.'" *Bernina Distributors, Inc. v. Bernina Sewing Machines*, 646 F.2d 434, 440 (10th Cir. 1981). An increase in price has nothing to do with unconscionability. *Id.* The record below reflects that Clause 6 (b) resulted from months of negotiation between experienced businessmen, Mr. Magagna and Mr. Barrett, respectively, representing Northern and Amoco. Each side made concessions in order to strike a bargain with which each was satisfied in 1970. There is simply no evidence in the record of overreaching or superior bargaining power on the part of Amoco. After a period of two (2) years following the execution of the amended contract, Northern finally persuaded Kerr-McGee and Phillips to enter into identical contracts containing the Clause 6 (b) favored nations clause. Northern now seeks judicial intervention to be relieved from what it believes was an unwise bargain. Both Amoco and Northern are sophisticated parties. Each entered into the contract knowing full well that events beyond their control to occur in future years would dictate whether the contract, in hindsight, was well or ill-conceived. The Court of Appeals was correct in holding as a matter of law that Northern had failed to demonstrate unconscionability under Wyoming law.

## II.

## CLAUSE 6 (b) OFFENDS NEITHER THE PUBLIC POLICY OF THE UNITED STATES NOR THE STATE OF WYOMING.

In the area of production and sale of natural gas, national policy unquestionably has been codified in the National Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3300, *et seq.* The NGPA is a comprehensive regulatory scheme governing the maximum price which may be charged for the sale of all natural gas produced in the country. The NGPA imposed federal price controls on the intrastate market for the first time in 1978. Further, the NGPA permits the price under intrastate gas contracts to rise through the operation of indefinite price escalator clauses up to the maximum rate established by the Act. 15 U.S.C. § 3315.

Under the NGPA, the conflicting interest between producers and consumers have been balanced by Congress. *Pennzoil Company v. FERC*, 645 F.2d 360, 379 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 1000 (1982). As recognized by the Court of Appeals, Congress determined that a high price for natural gas is an effective method of conservation. 1978 U. S. Code Congressional and Administrative News 8800, 8806. The price to be paid for natural gas by Northern to Amoco pursuant to Clause 6 (b) is the maximum lawful price permitted by the NGPA. The national public policy is not offended by the operation of Clause 6 (b). The Court of Appeals properly so found.

Northern's argument that the presence of the Wyoming Attorney General as *amicus curiae* in opposition to the validity of Clause 6 (b) is reflective of Wyoming's public policy, is nothing more than a bootstrapping ploy. It is the pronouncements of the Wyoming legislature and Wyoming's highest court which are dispositive on the public policy of the State.

The legislature of Wyoming, through its inaction, has clearly indicated that indefinite price escalator clauses are not violative

of Wyoming's public policy. In the NGPA, Congress extended to the states the invitation to enact further restrictions on the operation of indefinite price escalator clauses where such restrictions were deemed in the best interest of the state. As the Court of Appeals pointed out, some states have exercised their right to impose greater restrictions, but Wyoming is not one of them. The significance must be acknowledged.

Further, Northern's restrictive reading of *Amoco Production Company v. Stauffer Chemical Company*, 612 P.2d 463 (Wyo. 1980), cannot withstand analysis. The Wyoming Supreme Court, unconvinced by arguments of public policy, recognized the validity of favored nations clauses such as the one at issue herein.

> Favored nation clauses are a common feature of gas purchase and sale contracts. The nature of the product and its questionable availability engenders reluctance on the part of producers to enter into long-term contracts at the price prevailing at the time of the contract. Yet purchasers require long-term commitments to insure an adequate supply of gas . . . . A third party favored nation clause requires the purchaser to match any higher price contracted to be paid by any other buyer in the same field or area (citations omitted). Favored nation clauses are recognized by the courts . . . .
>
> The principle objective of such clauses is to escalate the agreed price to equal the ***highest*** price being paid for the commodity by any other purchaser.

*Id.* at 468.

The distinctions which Northern argues destroy the precedential value of *Stauffer* are not material to the decision. As recognized by the majority in *Superior Oil Company v. Western Slope Gas Company*, 604 F.2d 1281, 1291, n. 15 (10th Cir. 1979), "(t)he actual value of a product is determined by what people will pay for it, not by what it cost to produce." Pricing concepts such as vintaging, small producers' incentives and the like are irrelevant to the issues presented on appeal. *See Amoco*

*Production Company v. Kansas Power & Light Company*, 505 F. Supp. 628, 639 (D. Kan. 1980). The Court of Appeals below properly concluded that Clause 6 (b) does not offend the public policy of the State of Wyoming.

## CONCLUSION

For the reasons stated above, the Petition for Certiorari should be denied.

Respectfully submitted,

John S. Pfeiffer
GORSUCH, KIRGIS, CAMPBELL,
WALKER AND GROVER
1200 American National Bank Building
818 Seventeenth Street
Denver, Colorado 80202
Telephone: (303) 534-1200

ROBERT H. LANDT
Amoco Production Company
Amoco Building
Denver, Colorado 80202
Telephone: (303) 830-4689

*Attorneys for Respondent*
*Amoco Production Company*

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No. 82-434

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1982

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

v.

KERR-MCGEE CORPORATION, a Delaware corporation,
*Respondent.*

NORTHERN UTILITIES, INC., a Wyoming corporation,
*Petitioner,*

v.

AMOCO PRODUCTION COMPANY, a Delaware corporation
and PHILLIPS PETROLEUM COMPANY,
a Delaware corporation.
*Respondents.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

## REPLY OF NORTHERN UTILITIES, INC. TO BRIEFS IN OPPOSITION TO PETITION FOR CERTIORARI

WILLIAM H. BROWN
500 Petroleum Building
Casper, WY 82601
(307) 265-9210
*Counsel of Record for Northern Utilities, Inc., Petitioner*

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**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit**

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## REPLY OF NORTHERN UTILITIES, INC. TO BRIEFS IN OPPOSITION TO PETITION FOR CERTIORARI

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The presentations of arguments in the briefs opposing the petition of Northern Utilities, Inc. for a writ of certiorari are efforts to obscure what this case is all about and gloss over the unusual circumstances which caused the district court to conclude that the third-party favored

nations clause in the producers' gas sales contracts was void as against public policy and unconscionable when made. The failure of the court of appeals to understand these circumstances has resulted in a decision which calls for the exercise by this Court of its power of supervision through the grant of a writ of certiorari.

1. *Uniqueness.* Amoco contends that Article 6(b) is an example of a "common" clause[1], and in any event, Kerr-McGee and Phillips complain that "[t]he Petition fails to explain why uniqueness is relevant to unconscionability"[2]. Clauses generically denominated "favored nations clauses" may be common, but Article 6(b) most decidedly is not. The district court found that "Clause 6(b) is *not* a standard clause of common use in the industry, but is a unique provision. Arles H. Barrett, of Amoco, testified that he knows of no other contract containing this clause"[3]. Mr. Barrett, the Amoco representative who conceived of the clause and under whose direction it was drafted, testified that the distinguishing feature rendering it unique is that "[v]ery often third party Favored Nations provisions do have some limitations", but that Article 6(b) does not.[4]

The unconscionable reach of the clause can not be dismissed by rationalizing that it is a common and necessary incident of natural gas contracts. The indefiniteness of Article 6(b) admits of no adjustment for even such fundamental differences as measurement factors. No court

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[1] Amoco Brief, p. 2.

[2] Kerr-McGee and Phillips Brief, p. 9, footnote 8.

[3] Finding 15, Petition, p. 26(a) (emphasis added).

[4] Tr. 231.

of law or conscience has enforced such a bargain. The absence of a pressure base adjustment effectively permits the producers to apply a third party's price per gallon to a contract whose unit of sale is a quart. The absence of a Btu adjustment enables the producers to charge the price received by a third party seller of gas rich in heating value, despite that the producers here, in fact, process Beaver Creek gas to remove the high Btu components of the naturally occurring gas before delivery to Northern. Similarly, the indefiniteness of the Article 6(b) language enables the producers to claim reimbursement for more production related taxes than they actually pay. Contrary to the briefs of respondents[5], these facts were inexplicably ignored by the court of appeals below.

2. *Federal Public Policy.* Kerr-McGee and Phillips argue (at p. 7) that "the Court of Appeals' analysis of federal public policy is fully in accord with . . . other decisions within the Tenth Circuit" and cite, as an example, *Amoco Production Co.* v. *Kansas Power & Light Co.*, 505 F. Suppl. 628 (D. Kan. 1980). Respondent Amoco cites page 639 of the same decision (at pp. 10-11) for the proposition that "pricing concepts such as vintaging, small producers' incentives and the like are irrelevant to the issues presented on appeal." But there is no mention at all of "vintaging" or "small producers' incentives" at 505 F. Supp. at 639. What *is* presented there is a discussion of the Wyoming District Court's decision in the present case (*Kerr-McGee Corp.* v. *Northern Utilities, Inc.*, 500 F. Supp. 628 (D. Wyo. 1980) and an explanation of why the Kansas District Court reached a different

[5] Amoco Brief, p. 5; Kerr-McGee and Phillips Brief, p. 8.

result in approving the favored nations clause which was before it in *Amoco* v. *KP&L:*

> ". . . Since all of the gas provided by Northern Utilities' contracts was intrastate, they were not subject to federal price controls. If the relevant federal price controls applied, then the quoted price escalation clause would not have been triggered, since none of the defendant producers qualified as 'small producers' . . . and all of the gas supplied the plaintiff came from wells drilled prior to 1973.
>
> "Unlike KP&L, Northern Utilities agreed to pay the price escalations demanded by the gas producers until it could either work out a settlement or obtain a court decision on the price question. *Id* at 631-32. The effect of the price escalation for the customers of Northern Utilities, Inc. was dramatic. Between December, 1975, and April, 1980, a period of slightly over four years, the price rose from 28¢/MCF to $2.80/MCF. This represented a ten-fold increase over what would have been the contract price for the gas." (505 F. Supp. at 628-629.)

In distinguishing the facts in *Northern Utilities* from the facts before it, the Kansas District Court stated that "this Court does not disagree with the findings in that case given the circumstances presented there" (505 F. Supp. at 629), citing, in particular, the following:

> —in *Northern Utilities* "the gas producers alone supplied the problematic escalator clause" (while KP&L "had substantial input" in the drafting of the clause in its contract).
>
> —"the price increase for KP&L amounts to slightly more than a two and one-half fold escalation" compared with the "dramatic" ten-fold increase in *Northern Utilities*.
>
> —The KP&L escalation clause was activated for less than a year and a half while in *Northern Utilities* the clause "would have operated for twenty years . . . or

> until 1985 if the Natural Gas Policy Act of 1978 should operate to deregulate the price of gas under the contract."

This discussion in *KP&L* underscores the fundamental point that decisions in other cases involving more limited favored nations clauses do not support the result reached by the Court of Appeals in the present case.

3. *Wyoming Public Policy.* The Briefs in Opposition argue that the *amicus* participation of the State of Wyoming "cannot constitute the public policy of a state."[6] This ignores the mandate under Wyoming law by which the Attorney General is "required to attend to the interests of the state in all suits, actions or claims in which the state is or may become interested . . . in any of the United States courts."[7] The people of the State of Wyoming had a right to be heard in this proceeding, and the Attorney General was their appropriate spokesman. Indeed, in a Tenth Circuit case often relied on by Respondents, the *amicus* support of the indefinite price escalator clause there at issue by the state regulatory body was a material consideration of the court. *Superior Oil Co.* v. *Western Slope Gas Co.*, 604 F.2d 1281, 1285-86 (10th Cir. 1979). The *amicus* participation of the State of Wyoming in this case is not a "bootstrapping ploy" to establish Wyoming public policy, as argued by Respondents[8], and should not be dismissed by the Federal courts as a meaningless and empty act.[9]

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[6] Brief of Kerr-McGee and Phillips, p. 12. See also Brief of Amoco at p. 9.

[7] Wyoming Statutes, § 9-2-505 (1977).

[8] Brief of Amoco, p. 9.

[9] If there is any "bootstrapping" of the public policy issue being attempted in this case, it is by the producers as respects federal

Finally, the beneficiaries of the ten-fold price increase in Beaver Creek gas argue that this dramatic leap in price for 85% of Northern's gas supply somehow did not trickle down to the consumer. They argue that the increase in a typical residential consumer's monthly bill from $30 in 1975 to between $285 and $300 in 1980 was merely hypothetical and that in fact the 1980 figure is only $46.50.[10] While the $46.50 figure may represent the annual average, the testimony makes clear that the *wintertime* gas bill in 1980 was between $285 and $300.[11] The fact that a ten-fold increase in the price of Beaver Creek gas has resulted in an eight to nine-fold increase in consumers' bills cannot be denied. And if the Beaver Creek price had not been regulated at the time of trial, the typical consumers' wintertime bill would have been between $520 and $530 per month.[12]

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public policy. They argue that the courts should stand aside and permit Article 6(b) to escalate up to its "statutory ceiling." (Brief of Kerr-McGee and Phillips, p. 6. See also Brief of Amoco at p. 9) One is led to believe that the Congress, in its wisdom, has prescribed a precise price level consistent with federal policy. The Congress has done no such thing. Under the NGPA, the "maximum lawful price" for Beaver Creek gas is the *lesser* of the "new" gas price or *the price under the contract itself*. Natural Gas Policy Act of 1978, Section 105(b)(1); 15 U.S.C. § 3315(b)(1). If Article 6(b) is void, as the district court determined, then the statutory ceiling is the price under the remaining terms of the contract. That price, as the statutory ceiling, would then represent the federal policy as argued by the producers.

[10] Brief of Kerr-McGee and Phillips, p. 13.

[11] Tr. 339.

[12] Tr. 341.

4. *Ratification by Kerr-McGee and Phillips.* The contention by Kerr-McGee and Phillips that "[t]he evidence of bargaining conduct introduced against Amoco was expressly excluded from evidence introduced against Kerr-McGee and Phillips"[13] does not stand scrutiny. In fact, the objection of Kerr-McGee and Phillips was overruled.[14] The district court's findings reflect that Kerr-McGee and Phillips *ratified* the negotiations which Amoco had concluded: "Both Phillips and Kerr-McGee ratified the 1957 Amoco Contract without negotiations with Northern."[15] Not having negotiated with Northern on their own behalf, Kerr-McGee and Phillips must be judged in the same light as Amoco.

## CONCLUSION

For the reasons stated above and in Northern Utilities' original petition the requested writ of certiorari should be granted.

Respectfully submitted,

WILLIAM H. BROWN
BROWN, DREW, APOSTOLOS,
MASSEY & SULLIVAN
500 Petroleum Building
Casper, WY 82601
*Counsel of Record*
*for Petitioner*

October 25, 1982

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[13] Brief of Kerr-McGee and Phillips, p. 10, footnote 9.

[14] Tr. 263. The Court's reference to Rule 104 of the Federal Rules of Evidence is at best ambiguous. Any ambiguity is made clear in the Court's finding.

[15] Finding 12, Petition, p. 25a.

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*On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit*

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## BRIEF OF THE STATE OF WYOMING AS AMICUS CURIAE IN SUPPORT OF PETITION OF WRIT OF CERTIORARI

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STEVEN F. FREUDENTHAL
*Attorney General*
STEVEN R. SHANAHAN
*Senior Assistant Attorney General*
DENNIS M. BOAL
*Assistant Attorney General*
*(Counsel of Record)*
*State of Wyoming*
*123 Capitol Building*
*Cheyenne, Wyoming 82002*
*(307) 777-7841*

## QUESTION PRESENTED

Did the Court of Appeals err in holding that an indefinite price escalator clause in a contract for the intrastate sale of natural gas is not contrary to federal or state public policy.

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*On Writ of Certiorari to the United States*
*Court of Appeals for the Tenth Circuit*

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## BRIEF OF THE STATE OF WYOMING AS AMICUS CURIAE IN SUPPORT OF PETITION OF WRIT OF CERTIORARI

---

## INTEREST OF AMICUS

These consolidated cases concern the enforcement of an indefinite price escalator clause in three contracts for the intrastate sale of natural gas in Wyoming. The clause is designated as Article 6(b) in the three contracts and is identical in each case. Northern Utilities, Inc. (Northern) is the purchaser of the gas under each contract and the Respondents, Amoco Production Co., Kerr-McGee Corporation, and Phillips Petroleum Company, are the producers and sellers of the gas.

Northern is an intrastate public utility and its rates, service and earnings are regulated by the Public Service Commission of Wyoming. The gas purchased by Northern from the producers pursuant to the contracts is resold to residential consumers in several Wyoming communities. Ultimately, it is these consumers and citizens of Wyoming who will bear the cost of the gas purchased by Northern from the producers, and it is these citizens who will become the eventual victims of the oppressive escalator clause found in the contracts. As a matter of law, Northern is entitled to recover the cost of the gas through rates which are sufficient to pay the costs of the gas plus a reasonable rate of return on the utilities' investment.

Approximately 85% of the natural gas acquired by Northern for resale to the public is purchased pursuant to the contracts in question. Because of the escalator clause, the cost of natural gas to consumers served by Northern has increased from a price of approximately 28 cents per Mcf in December, 1975, to a price of approximately $2.80 per Mcf in April, 1980, or an increase of ten times in a period of approximately four years. The consumers' monthly gas bill of $30 has been increased to approximately $250, and is still on the rise.

This economic hardship being imposed on Wyoming ratepayers is the result of a price escalation clause, Article 6(b), which the producers claim entitles them to the highest price paid for any gas produced in Wyoming and

sold in interstate commerce, without regard to the fact that the most expensive interstate gas may be the result of a higher heating value, higher pressure base, higher taxes included in the price, or the function of extraordinary price allowances established by the Federal Power Commission. This interpretation by Amoco, Phillips and Kerr-McGee has and will continue to create an inequitable, illegal and oppressive result, causing Wyoming ratepayers to be charged exorbitant prices for the natural gas.

Despite the apparent inequities and economic burden imposed on Wyoming citizens because of the one-sided price escalator clause, the United States Court of Appeals for the Tenth Circuit reversed a District Court ruling which held that Article 6(b) was unenforceable on the grounds that it was contrary to public policy and unconscionable. The decision of the Court of Appeals has a profound impact on thousands of Wyoming consumers and consequently, certiorari should issue.

## REASONS FOR GRANTING THE WRIT

## THE DECISION BELOW IS IN CONFLICT WITH FEDERAL AND STATE PUBLIC POLICY AND IS CONTRARY TO THE PUBLIC INTEREST.

### I. FEDERAL PUBLIC POLICY

The Court of Appeals found that the escalator clause was not contrary to federal energy policy by relying on the Natural Gas Policy Act of 1978, 15 U.S.C. Section 3301, *et seq.* (NGPA). The Court noted that the Act specifically allows the price under intrastate gas contracts to rise through the operation of an indefinite price escalator clause. Because of this acknowledgment in the NGPA, the Court of Appeals seems to conclude that the use of an indefinite escalator clause is in keeping with federal policy

no matter how the clause is conceived or applied.

This conclusion is incorrect and in fact, this case provides a classic example of where an indefinite price escalator clause is being used to frustrate federal energy policy. For example, in 1975, the Federal Power Commission established a special price allowance for the sale of natural gas by small producers. *See*, FPC Opinion No. 742. The price allowance enabled small producers to sell their gas at a higher rate than large producers. The purpose for the "small producer incentive" was to encourage the small producer to develop new supplies of natural gas for the interstate market. None of the producers in this case could have qualified for the incentive if they were selling their gas in the interstate market. Nevertheless, the producers have, by using the price escalator clause, imposed on Wyoming ratepayers the "small producer rate" even though new supplies of gas have not been developed and made available to the interstate market. The producers have instead reaped a windfall at the expense of Wyoming ratepayers. Federal energy policy is not being furthered by the use of the indefinite escalator clause in this case.

The producers are also using the incentives to develop new natural gas provided in the NGPA in a similar fashion. Several provisions of the Act are directed towards encouraging the development of new gas supplies for the interstate market by allowing a higher base price for new gas. None of the gas being provided by the producers pursuant to the contracts would qualify as new gas or the new gas rate. Once again, the producers have, through the indefinite escalator clause, burdened the Wyoming ratepayers with the "new gas rate" even though they have not undertaken any activities here which would provide new gas supplies for the interstate market.

The use of the escalator clause in this situation is not consistent with federal policy. The purpose of the NGPA is to control prices of natural gas while encouraging the development of new supplies. *Pennzoil Co. v. Federal Energy*

*Regulatory Commission*, 645 F.2d 360 (5th Cir. 1981). Congess did not intend the Act be used as a means for major energy companies to charge exorbitant prices for their gas without taking any additional risk or expense in locating new supplies.

## II. STATE PUBLIC POLICY

The Court of Appeals has also misinterpreted the state public policy regarding this matter. The public policy of the state may be found in its constitution and statutes and when they have not directly spoken, then it may be found in the decisions of the Court and in the regular practice of government officials. *Taylor v. State*, 612 P.2d 851, 865 (Wyo. 1980), (Rooney, J. concurring). The State of Wyoming through its Attorney General has appeared in this case at every stage as *amicus curiae* and has expressed the public policy of the State of Wyoming.

From the beginning, the State has maintained that the use of the escalator clause by the producers in this case is unconscionable and contrary to the public interest. As noted by the District Court in its decision, "paragraph 6(b) causes windfall profits and substantially increases the costs to consumers for a commodity without which they may well not be able to live." (Finding No. 21.) The State contends that a contract clause which would bring about such a harsh result is contrary to the public interest and unenforceable. *See e.g., Riddley v. Kraut*, 63 Wyo. 252, 180 P.2d 124 (1947); *Rural Electric Co. v. State Board of Equalization*, 57 Wyo. 451, 120 P.2d 741 (1942).

The Circuit Court observed that the Courts of Equity may, and frequently do, go much further to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved. *Virginian Railway v. System Federation No. 40*, 300 U.S. 515, 552 (1936). There is no question the courts have the power to protect the public's interest. The Court of

Appeals in this case has failed to do so and certiorari should be issued.

## CONCLUSION

For the foregoing reasons, the State of Wyoming requests that a Writ of Certiorari be issued in this case.

Respectfully submitted,

STEVEN F. FREUDENTHAL
*Attorney General*

STEVEN R. SHANAHAN
*Senior Assistant Attorney General*

DENNIS M. BOAL
*Assistant Attorney General*
*(Counsel of Record)*

*State of Wyoming*
*123 Capitol Building*
*Cheyenne, Wyoming 82002*
*(307) 777-7841*